

Regulatory Impact Statement: Local Government Water Services Bill

Coversheet

Purpose of Document	
Decision sought:	Agree to final policy proposals to support the third stage of Local Water Done Well via the Local Government Water Services Bill.
Advising agencies:	Department of Internal Affairs and the Ministry of Business, Innovation and Employment.
Proposing Ministers:	Hon Simeon Brown, Minister of Local Government, and Hon Andrew Bayly, Minister of Commerce and Consumer Affairs.
Date finalised:	12 June 2024
Problem Definition	
<p>Without systemic change, council ownership and delivery of water services is financially unsustainable and not always meeting the minimum quality standards. This is evidenced by large proposed increases in investments by councils in water services by as much as 65% in the first three years of their draft council long-term plans over investments signalled in their previous 2021-2031 long-term plans. These large increases in investments are contributing to large projected rates increases, with average rates across all councils estimated to increase 15% next year, with 10% increases in each of the two following years. The size of proposed rates increases varies across councils ranging from 3% for Westland District to 28% for Napier District, with 36 councils proposing rates increases greater than the average.</p> <p>Five root causes were identified in the first Regulatory Impact Statement (the first RIS) prepared for the Local Government (Water Services Preliminary Arrangements) Bill as contributing to this problem:</p> <ul style="list-style-type: none">• institutional barriers to more efficient delivery of water services• poor incentives on councils to adequately invest in and fund water services• varied decision-making quality• funding constraints, and• incomplete regulatory and stewardship oversight and monitoring. <p>Of particular relevance to this RIS are the following specific considerations related to each of the above root causes:</p> <ul style="list-style-type: none">• Institutional barriers to more efficient delivery of water services: The fragmented and dispersed manner in which water services are delivered across 67 local authorities of varying sizes and capabilities has an impact on their overall quality and efficiency. In particular, there is a lack of legislative requirements to require councils to financially ringfence water services from other council services and functions to enable their improved financial management, to enable councils to provide water services through	

organisations that are financially separated from those of other council services to provide for increased debt financing.

- **Poor incentives on councils to adequately invest in and fund water services:** Councils and their executives have to prioritise investments and make trade-offs across a portfolio of activities, often in the context of a three-year political cycle. Councils are not currently subject to the disciplines and incentives of independent economic regulation in their delivery of water services.
- **Varied decision-making quality:** Councils may have to trade off investments in water services against other political priorities. They may also underfund water services to reduce pressures on rates and development contributions. This can result in varied and sometimes poor council decisions on the delivery of water services.
- **Funding constraints:** Constraints on existing council balance sheets to borrow more money to invest in water services, coupled sometimes with insufficient revenue through rates and other charges to cover the ongoing costs of water services and investment in water infrastructure.
- **Incomplete regulatory and stewardship oversight and monitoring:** Since the establishment of Taumata Arowai, the regulation of drinking water is set to improve but New Zealand does not have economic regulation to ensure the efficient delivery of services by councils and protect the interests of consumers. In the absence of a dedicated economic regulator, there is a lack of regulatory and system stewardship to protect consumer interests in councils' delivery of water services, including inadequate ongoing independent scrutiny, oversight and reporting of council performance, including whether councils and their CCOs are being efficient in their delivery of water services.

Executive Summary

Local Water Done Well

The Coalition Government's stated approach to implementing its policy to improve council delivery of water services involves two stages of policy development, following its repeal in February 2024 of the Water Services Entities Act 2022, Water Services Legislation Act 2023 and the Water Services Economic Efficiency and Consumer Protection Act 2023.

Under Local Water Done Well (LWDW), the policy objective is that councils deliver water services that are financially sustainable and meet minimum regulated drinking and environmental quality standards. The delivery of water services will continue to be led by councils in recognition that each region requires an individual solution, as opposed to a one-size-fits-all centrally imposed approach.

The two stages of policy development involve:

- **Preliminary arrangements**¹ that were agreed to by Cabinet in March 2024 to ensure an immediate council focus on planning to achieve the financial

¹ This was previously referred to as "Transitional Arrangements" in the first RIS

sustainability of their water services, while also providing for some water services providers to be subject to foundational information disclosure.

- **Longer term provisions** to expose all councils to the disciplines and incentives of the reforms including ringfencing requirements, economic regulation, and structural models to improve the financial performance of water services for consumers.

The first RIS evaluated the preliminary arrangements, as well as the government's overall strategic approach to improving council delivery of water services.

This RIS evaluates the first set of longer-term proposals.

This RIS examines four further proposals to support the recommended Strategic Option Two

In the previous RIS, four broad Strategic Options were outlined as available to the Government as it considers what it can do to enable and support local authorities to deliver water services that are financially sustainable and meet minimum regulated quality standards.

The Department of Internal Affairs (the Department) recommended **Strategic Option Two**² as it aligns with LWDW and provides the necessary incentives and support for councils to improve delivery of their water services in the lead up to full economic regulation in the Local Government Water Services Bill. Strategic Option Two aimed to enable council reorganisation of water services in the lead up to economic regulation. A combination of the four key proposals would ensure council focus on what is needed to put their water services onto sustainable financial footings as a basis for their transition to full economic regulation in the future.

This RIS sets out an analysis of identified options across **four further proposals** that start to set the enduring foundations within the water services delivery sector.

These proposals sit across four areas:

- Optionality for water services providers
- Minimum requirements for financial separation
- Introduction of economic regulation
- Assistance and intervention framework.

Proposal One: Optionality for water services providers

- Option One: Current set of available water services providers options set out in legislation, including transitional consultation provisions provided for in Bill 2 (counterfactual).
- Option Two: Legislative change to enable a broad range of water services providers, with clear minimum requirements (the Department's approach).

² The major feature of Strategic Option Two is the inclusion of transitional provisions to enable councils to focus on the sustainable financial delivery of their water services, to inform government's development and implementation of economic regulation, and to enable councils to prepare for full economic regulation, while maintaining a focus on local control. The rejected Strategic Options ranged from the then status quo, to immediate change with no transitional mechanisms, to stronger central direction.

- Option Three: Legislative change to enable new water services providers with clear minimum requirements (as per option 2), but council choice is restricted to specified models.

Option Two would provide councils with a greater span of choice and options that can be tailored to different local characteristics, including delivery models that will improve incentives and efficiency and enable the effective management and delivery of financially sustainable water services by councils. These new vehicles enable councils to potentially achieve economies of scale, where that makes sense to achieve more efficient service delivery; and enable better access to financing for water services, including by facilitating long-term borrowing.

Proposal Two: Minimum requirements for financial separation

- Option One: No explicit ringfencing requirements (counterfactual)
- Option Two: Stand-alone financial statements are required for water supply, wastewater, stormwater, and the three waters in aggregate (the Department's preferred approach)
- Option Three: Hypothecation of water revenues under specific circumstances (the Department's preferred approach)

Options Two and Three together would transparently disclose the true cost of water services (including deferred maintenance/renewal, as well as the whole-of-life costs of new infrastructure) delivery and infrastructure investment and whether revenues are sufficient to cover costs and provide a proxy for operational and financial separation of water services from other council business. They will also enable management and governance to have an appropriate level of oversight of water services revenue and costs, and assist with investment and financing planning, and support the economic regulator through more transparent disclosure.

Proposal Three: Introduction of enduring economic regulation (led by the Ministry of Business, Innovation and Employment (MBIE))

- Option One: Existing transitional provisions and information disclosure remain (counterfactual)
- Option Two: A targeted approach to economic regulation, with the ability to group water service providers (MBIE's preferred approach)
- Option Three: A comprehensive approach to economic regulation introduced for each water services provider.

Option Two ensures efficiency by moving towards the provision of water services at the lowest possible long-run cost (subject to improved water quality and infrastructure standards), incentivising the recovery of costs and efficient investment in water infrastructure and ensuring prices /charges reflect the costs of delivering water services.

Under this proposal there would be the creation of a power enabling cost of the economic regulation regime to be recovered from levies on water service providers. This is discussed further in the attached Cost Recovery Impact Statement (See Annex Two)

Proposal four: Assistance and intervention

- Option One: Current framework for Ministerial powers of assistance and intervention framework (in Part 10 of the LGA) plus additional mechanisms

provided for in Bill 2 in relation to council Water Services Delivery Plans (counterfactual)

- Option Two: Strengthened assistance and intervention framework for the water services provided directly by councils (building on counterfactual arrangements)
- Option Three: Strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on preliminary arrangements) (the Department's preferred approach)

Option Three provides for a comprehensive, transparent and easy to understand statutory framework that is suitable for all forms of local government water services providers and arrangements. It would provide flexibility to address a wide range of problems, and agility to ensure matters can be dealt with quickly.

Limitations and Constraints on Analysis

There are limitations and assumptions within these policy proposals.

The same limitations with the problem definitions and analysis, and Strategic Options apply as the first RIS.

- The problem definition uses evidence collected from a range of councils across New Zealand. A detailed comparison or analysis of all councils has not been included as part of this problem definition and, as each council is different, some situations described may not apply to all councils.
- It has been assumed that if central government regulatory intervention to improve council performance in water services delivery, including enabling policy and legislative settings, is not progressed, underinvestment in water services delivery by councils will continue and the problem will continue to worsen.
- Some analysis relies on work completed as part of the previous Government's water services reform. It is recognised that some significant step changes have occurred within the water services delivery system since the previous RISs were drafted including the establishment of the new drinking water regulatory system by Taumata Arowai and increased council and public focus on water services delivery.
- The proposed Strategic Options are informed by, and limited to, the Government's policy. This prioritisation has meant that other potential Strategic Options or delivery models have not been included for consideration (for example, the centralised delivery model proposed as part of the previous government's reform).

The policy proposals are informed by, and limited to, Government policy

- Along with the Strategic Options, detailed policy proposals are also informed by, and limited to, the Government's policy. This includes the key parameters set out in LWDW, including, but not limited to, that councils will retain ownership and control of their water services assets and delivery; councils will be able to choose a suitable delivery vehicle (including choosing the status quo) that would be subject to minimum requirement, and councils will be required to ringfence assets and funds for water infrastructure.

- These parameters have limited the scope of options considered, e.g. the establishment of a water service regulator within the Commerce Commission.
- It is also assumed that there will be no Crown funding or financial support provided to councils, including for example a liquidity facility (not just a cash injection).

The policy proposals take into account the interaction with the preliminary provisions

- Given the timing of Bill 2, and the interconnectedness with the proposals in this RIS (and associated Cabinet paper), it is assumed throughout the analysis that the Bill will pass – creating the counterfactual in the analysis.

There are further policy proposals to come

- Assessments of proposals have had to be made in isolation of the more detailed proposals to come, without the ability to see the overall impact and interconnectedness.

There has been limited consultation and engagement with stakeholders

- There has been limited consultation with stakeholders during the overall policy design process. This includes with sector organisations, councils, iwi and hapū and other interest groups. As such, there are no views of councils included in this RIS.
- However, there has been some engagement with several councils on these proposals, including delivery arrangements. Further engagement is anticipated as councils commence their Water Service Delivery Plans once Bill 2 is enacted and when guidance material is made available.
- Officials have relied on:
 - the government's newly established Technical Advisory Group (TAG) who provided policy design input into the proposals included in this RIS
 - evidence and insights collected through the public consultation from the previous policy and legislative programme, noting that this was extensive, and
 - insights provided from the limited engagement with councils that has occurred.

The assessment of costs and benefits has had to rely on qualitative information

- Due to timeframes, data limitations and uncertainty as to how the various proposals will be implemented and responded to by councils it was not possible for the Department to complete a full analysis of the benefits of the four proposals beyond qualitative estimates.
- New Zealand consumers served by the new entities are expected to be the main beneficiaries of these proposals. Our assessment is largely based on qualitative analysis, based on other economic regulation regimes in New Zealand. The true costs of the economic regulation regime, including those to be faced by councils, are not fully known. These costs will depend on how economic and other regulation is implemented by the Commerce Commission and others, and the capability and capacity of different councils to respond to

the requirements of new regulation, including to achieve financial ringfencing of water services and to establish more efficient delivery models for water services.

Responsible Manager(s) (completed by relevant manager)

Bex Sullivan
 Deputy Executive Director
 Water Services Programme
 Department of Internal Affairs



12 June 2024

Quality Assurance (completed by QA panel)

<p>Reviewing Agency:</p>	<p>Joint panel between the Department of Internal Affairs and the Ministry of Business, Innovation and Employment</p>
<p>Panel Assessment & Comment:</p>	<p>The panel considers that the information and analysis summarised in the RIS and annexed CRIS partially meets the quality assurance criteria.</p> <p>The RIS and CRIS build upon the earlier March 2024 RIS for the proposals for the second stage of the Government’s Local Water Done Well (LWDW) programme; currently being progressed via the Local Government (Water Services Preliminary Arrangements) Bill. The panel’s comments largely reflect the assessment of that earlier RIS.</p> <p>The RIS provides, in the context of the agreed strategic approach to the LWDW reforms, a clear description of the problem, objectives and options and the criteria and framework to assess these.</p> <p>The RIS identifies the scope and timing constraints on the analysis which primarily result from Government policy direction. In particular, timeframe constraints have again resulted in insufficient consultation on the proposals, as required by the Cabinet criteria.</p> <p>The RIS also specifically notes that due to constrained timeframes, data limitations and uncertainty as to how the various proposals will be implemented and responded to by councils, there is no quantitative financial information in the RIS on the effects of various options on each proposal. This significantly impacts the cost benefit analysis of these options and the degree to which collectively the proposals will achieve the overall objective of local councils delivering water services that are financially sustainable and meet minimum regulated quality standards. However, the RIS acknowledges this limitation and the fact that different councils will have different capacities to implement the reforms. The RIS also outlines a multi-layered approach to ongoing oversight and monitoring at both the system-wide and individual council levels.</p>

As with the earlier RIS, the panel's assessment was also limited by timeframe constraints and the assessment took a quicker and more truncated process than usual. The panel provided a final set of comments on the revised draft of the RIS but did not see the final version. The panel were however of the view that this would not alter its overall assessment.

Abbreviations

CCO	Council-controlled organisation
CCTO	Council-controlled trading organisation
LGA	Local Government Act 2002
LTP	Long-term plan
LWDW	Local Water Done Well
TAG	Technical Advisory Group
The Commission	Commerce Commission
The Department	The Department of Internal Affairs
Bill 2	Local Government (Water Services Preliminary Arrangements) Bill
Bill 3	Local Government Water Services Bill

Introduction

1. Local Water Done Well (LWDW) aims to support councils to deliver water services that are financially sustainable and meet minimum regulated quality standards.
2. Following its repeal in February 2024 of the Water Services Entities Act 2022 and the Water Services Economic Efficiency and Consumer Protection Act 2023, the Coalition Government's stated approach to implementing its policy to improve council delivery of water services involves two stages of policy development:
 - **Preliminary arrangements** that were agreed to by Cabinet in March 2024 to ensure immediate council focus on planning to achieve the financial sustainability of their water services, while also providing for some water services providers to be subject to foundational information disclosure
 - **Longer term provisions** to expose all councils to the disciplines and incentives of the reforms including ringfencing requirements, economic regulation, and structural models to improve the financial performance of council water services for consumers. A set of those provisions is discussed in this document.

Preliminary arrangements have been agreed and were assessed as part of the first RIS

3. Preliminary arrangements were agreed by Cabinet in March 2024, with the intention to introduce and pass legislation (Local Government (Water Services Preliminary Arrangements) Bill (Bill 2)) by August 2024 that will establish a framework and preliminary arrangements for the new water services system.
4. These arrangements aimed to ensure immediate council focus on planning to achieve the financial sustainability of their water services, while also providing for information to inform the design and implementation of economic regulation.
5. Cabinet agreed to:
 - providing a framework for councils to self-determine future service delivery arrangements via a Water Services Delivery Plan
 - the potential for water services providers to be subject to information disclosure requirements
 - streamlining requirements for establishing council-controlled organisations (CCOs) under the Local Government Act (LGA) to enable councils to start shifting the delivery of water services into more financially sustainable configurations, should they wish to do so, and
 - provisions that enable a new financially sustainable model for Watercare.
6. Alongside these proposals, a first Regulatory Impact Statement (the first RIS) was produced in March 2024, which evaluated the above proposals, as well as the Government's overall strategic approach to improving council delivery of water services.

This RIS evaluates the first set of longer-term proposals

7. As noted above, the aim of the longer-term provisions is to expose councils to the disciplines and incentives of economic regulation, provide them with new organisational options for the delivery of water services, and ringfence and increase investments in water services while also providing for more operational efficiencies in their delivery.

8. This RIS, and accompanying two Cabinet papers, assess the first set of policy proposals to do this. These proposals will form the basis for the Local Government Water Services Bill (Bill 3) and are led by both the Department of Internal Affairs (the Department) and, in relation to economic regulation, the Ministry of Business, Innovation, and Employment (MBIE).
9. The specific proposals evaluated in this RIS include:
 - **New organisation structural and financing arrangements** that councils can employ to respond to new regulatory requirements, including a new class of financially independent CCOs
 - **New regulatory requirements** including:
 - **economic regulation** that will apply to councils in their delivery of water services to ensure consumers pay cost-reflective prices for water services that are delivered to an acceptable quality
 - **minimum requirements for financial separation** that will ensure water services providers are investing sufficiently in their infrastructure
 - **An enhanced framework** relating to Ministerial powers of assistance and intervention that is designed for the new approach to water service delivery.
10. A second set of longer-term proposals will be provided to Cabinet in the July, and a further RIS will be provided which assesses those proposals. It is expected that this will include proposals relating to:
 - the functions of water service providers
 - consumer protection
 - additional provisions relating to charging arrangements.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

11. As highlighted in the first RIS, drinking water, wastewater and stormwater infrastructure are critical to human wellbeing, and their provision is an essential enabler of residential and regional development, new housing provision and economic growth. Their provision and physical condition are also important to environmental quality and community resilience, of increasing importance because of climate change.
12. Councils provide drinking water, wastewater and stormwater services to most New Zealanders. There are currently 67 councils that own and operate water services across New Zealand. Around 85 percent of New Zealanders receive their drinking water and other water services from these councils, with the remainder provided by smaller private and community-based schemes.
13. The service delivery models employed by councils vary, and include in-house business units, CCOs, and a variety of contracting and sourcing arrangements to private operators and service delivery companies. Most councils directly own and manage their water services. These councils employ a variety of different approaches to the operation of water services including contracting and outsourcing arrangements for the operations, asset maintenance and renewals to third parties. Regardless of the operating model, councils are responsible and accountable under the LGA to their ratepayers through the local democratic system for the delivery of water services to their communities.
14. Councils are regulated in their delivery of water services:
 - The LGA includes obligations on councils to assess community access to water services, and to continue provision of existing water services, and requirements for long term planning of council operations including water services CCOs
 - Taumata Arowai-the Water Services Regulator Act 2020 and the Water Services Act 2021 provide for drinking water quality standards and their enforcement by Taumata Arowai, as well as wastewater and stormwater environmental network performance standards.
 - The Resource Management Act 1991 (RMA) provides for resource consent requirements and their monitoring, and monitoring of discharges and abstraction points by Regional Councils.
15. These points are expanded upon in the first RIS.

The preliminary arrangements will change the status quo

16. The Coalition Government has committed to LWDW, a locally-led approach to improving water services in New Zealand. Under LWDW:
 - councils will retain ownership and control of their water services assets and delivery
 - central government will have stronger oversight of council delivery of water services to ensure that the status quo does not continue, including introducing an economic regulator

- councils will be required to ringfence assets and funds for water infrastructure with the policy objective that water services will become financially sustainable, and
 - there is greater transparency and accountability to consumers, communities and regulators.
17. Bill 2 sets out the framework and initial operating environment for the replacement regime. It seeks to:
- establish foundational information disclosure requirements to support the long-term economic regulatory regime
 - require councils to develop Water Services Delivery Plans to be submitted within 12 months of the enactment of Bill Two to demonstrate how water services will be organised and managed to ensure that they are financially sustainable and meet regulatory compliance and service standards
 - remove barriers and streamline requirements on councils for establishing CCOs under the LGA, to make it easier for councils to reorganise their delivery of water services into more financially sustainable configurations, and
 - provide a bespoke approach for Watercare and Auckland Council to achieve the financial separation of water services and move to economic regulation ahead of other councils.

What is the policy problem or opportunity?

18. The policy problem is discussed in detail in the first RIS. Without systemic change, council ownership and delivery of water services is financially unsustainable and does not always meet minimum health and environmental quality standards.
19. Current council draft long-term plans (LTP) for the period 2024 – 2034 signal 65% more investment in water services than councils signalled in their 2021 – 2031 plans. This large increase in investment is contributing to average rates increases for the next year of 15%, with 10% increases in each of the two following years after. The size of proposed rate increases varies across councils ranging from 3% for Westland District to 28% for Napier District, with 36 councils proposing rates increases greater than the average.
20. In the first RIS, five root causes were identified as contributing to persistent systematic problems with the delivery of water infrastructure services by councils, being:
- institutional barriers to more efficient delivery of water services
 - poor incentives on councils to adequately invest in and fund water services
 - varied decision-making quality
 - funding constraints, and
 - incomplete regulatory and stewardship oversight and monitoring.
21. Specific considerations related to each of the root causes that are particularly relevant to this RIS are discussed below.

Institutional barriers to more efficient delivery of water services

22. The fragmented and dispersed manner in which water services are delivered across 67 local authorities of varying sizes and capabilities has an impact on their overall quality and efficiency.
23. Specifically relevant to this RIS are the lack of legislative requirements to require councils to financially ringfence water services from other council services and functions to enable their improved financial management, and to enable councils to provide water services through organisations that are financially separated from those of council owners to provide for increased debt financing of water services. Without increased debt financing, the investment gap to adequately fund water services will continue to grow.

Poor incentives on councils to adequately invest in and fund water services

24. Councils and their executives have to prioritise investments and make trade-offs across a portfolio of activities, in the context of a three-year political cycle. In this context, some councils have made decisions to defer investments in long life and largely underground assets in favour of more visible priorities to the detriment of future ratepayers.
25. Specifically relevant in relation to this RIS is that councils are not currently subject to the disciplines and incentives of independent economic regulation in their delivery and financial management of water services.

Varied decision-making quality

26. Water services are capital-intensive and complex. Those involved in decisions may not have the skills and capabilities needed to provide effective asset management and delivery of water services or to ask the right questions of those that manage water services, which leads to overall lower quality decision-making. Further, the politicisation of decision-making can have a negative impact on infrastructure management and investment.
27. Particularly relevant is that councils may have to trade off investments in water services against other priorities. They may also underfund water services to reduce pressures on rates and development contributions. This can result in varied and sometimes poor council decisions on the delivery of water services.

Funding and financing constraints

28. Poor past management and investment decisions have left many councils with water services that have not been adequately maintained or renewed. Further, some councils have not always charged enough through rates and other revenue sources to recover the whole-of-life costs of the water services they provide. The total debt positions of some councils means that they are unable to borrow sufficient to invest in needed improvements to existing infrastructure services or to extend provision of water services to enable growth. Sometimes constrained balance sheets and revenues have led to credit rating downgrades that have further increased costs of investment in water and other council services.
29. Of particular relevance to this RIS are the constraints on existing council balance sheets to borrow more money to invest in water services, coupled sometimes with insufficient pricing of water services through rates and other charges to generate the revenue necessary to cover the whole of life costs of providing water services.

Incomplete regulatory and stewardship oversight and monitoring

30. The comprehensiveness of regulation across water services is incomplete. Current regulation involves regulation of drinking water quality by Taumata Arowai and of the environmental impacts of water services by Regional Councils.
31. Particularly relevant to this RIS is that there is limited financial oversight of water services beyond the Department and Office of the Auditor-General, and that these roles are limited in their breadth and influence to protect the interests of consumers. Current oversight and reporting does not extend to the economic efficiency of council delivery of water services.
32. Since the establishment of Taumata Arowai, the regulation of drinking water quality has improved significantly but New Zealand does not have economic regulation of water services to ensure the efficient financial management and delivery of water services by councils. This means that the interests of consumers of water services are not protected in the same way that the interests of consumers of electricity and telecommunications services are.
33. In the absence of a dedicated economic regulator for water services, there is a lack of regulatory and system stewardship to protect consumer interests in councils' delivery of water services, including inadequate ongoing independent scrutiny, oversight and reporting of council performance in its management of water services including assurance that revenue is sufficient to provide for the costs of necessary investments in water services.

What objectives are sought in relation to the policy problem?

34. Combined, the roots causes identified above are inhibiting councils in their efforts to put delivery of their water services onto a financially sustainable footing. This includes being able to provide assurance to their communities that these services are meeting minimum regulatory requirements for drinking water safety and to reduce harmful environmental impacts associated with the delivery of water services, while also needing to improve resilience to natural hazards and climate change, and to enable residential development and economic growth.
35. The Department's proposed approach to solving the policy problem is linked to the key features of LWDW. The policy objective is that local councils deliver water services that are financially sustainable and meet minimum regulated quality standards for communities.
36. Under the Government's LWDW policy, **financial sustainability** means councils:
 - demonstrate revenue sufficiency, so that water services earn enough lifetime revenue from rates or water charges to cover costs
 - financially ringfence water services, to enable borrowing against that revenue and separate funding for other council services, and
 - are funding for growth, so that water services can access finance for growth whenever there are users willing to pay the cost of services.
37. For avoidance of doubt, this is focused on both legacy water infrastructure costs and future costs associated with meeting growth demands.
38. Regulatory quality standards means:
 - water quality standards set by Taumata Arowai and regional councils, and

- water infrastructure standards.
39. Within this, the delivery of water services will be led by councils and recognises that each region requires an individual solution, as opposed to a one-size-fits-all approach.
 40. The aim is that the overall approach set out in LWDW will empower communities and improve decision-making quality and set rules for quality and investment.
 41. Supporting councils to put water services onto a financially sustainable footing with adequate investment and funding is critical if services are to meet community expectations of quality including drinking water safety and provide for local and regional growth and development and other challenges such as those associated with climate change adaptation.

What are the limitations and assumptions of this RIS?

42. There are limitations and assumptions within these policy proposals. These are detailed below.

The same limitations with the problem definitions and analysis, and Strategic Options apply as the first RIS

43. The first RIS provides a detailed description of the limitations and assumptions for the problem definition and Strategic Options – alongside the detailed analysis for these. The relevant limitations that remain for this RIS are summarised below.
44. The problem definition uses evidence collected from a range of councils across New Zealand. A detailed comparison or analysis of all councils have not been included as part of this problem definition and it is important to note that each council is different, so some situations described may not apply to all councils.
45. It has been assumed that if central government intervention, including enabling policy and legislative settings, is not progressed, underinvestment in water services delivery will continue and the resulting problems will continue to worsen. As such, all three stages of LWDW will need to be implemented, otherwise under the status quo, council-owned water services will continue to degrade due to inconsistent management, under investment and under-funding.
46. Some analysis relies on work completed as part of the previous government's water services Reform. Some significant step changes have however occurred within the water services delivery system since the Regulatory Impact Statements related the previous governments proposals were drafted. These include implementation of new drinking water regulatory requirements under the provisions of the Water Services Act 2021 by Taumata Arowai and the recent repeal of the Water Services Entities Act 2022.
47. The LWDW policy was a key manifesto commitment of the National Party, and the repeal of the previous government's Water Services Entities Act 2022 features in the Coalition Government's 100-point Economic Plan. Therefore, the scope of policy options that are explored within the RIS are limited by the Coalition Government's position on the previous Reform, their manifesto commitments and coalition agreements.
48. As a result, the proposed Strategic Options are informed by, and limited to, the Government's policy. This prioritisation has meant that other potential Strategic Options or delivery models have not been included for consideration (for example, the centralised delivery model proposed as part of the previous government's Reform).

The policy proposals are informed by, and limited to, Government policy

49. Along with the Strategic Options, detailed policy proposals are also informed by, and limited to, the Government's policy. This includes the key parameters set out in within LWDW which are outlined earlier.
50. As part of this, a number of clear directions have already been set for the policy design which limit the scope of the options available to be considered. Some of these include:
 - the establishment of a clear set of rules that are based on the outcomes that are expected, but councils will be allowed to meet these rules in the manner they believe is best for their community – e.g. with the delivery vehicle of their choosing
 - the introduction of step-in powers for the Government if any council or group of councils are unable to deliver a viable plan that can deliver on outcomes for water quality, infrastructure investment and financial sustainability
 - the establishment of a water service regulator within the Commerce Commission (the Commission) to work alongside Taumata Arowai, and
 - water services providers to be regulated under Part 4 of the Commerce Act 1986.
51. It is also assumed that there will be no Crown funding or financial support provided to councils, including for example a liquidity facility (not just a cash injection).
52. Overall, it is assumed that the package of proposals presented, along with the preliminary arrangements provided for in Bill 2, will be implemented as a coherent set of initiatives to achieve the policy objective that local councils deliver water services that are **financially sustainable** and meet minimum regulated quality standards for communities.
53. Councils vary in their capabilities and capacity to raise debt and revenue to fund water services, and some councils are starting from a worse financial position than others. Because of these factors, some councils may struggle to respond to the incentives of economic regulation and to fully utilise new organisational options to achieve sufficient debt head room and efficiency gains to put their services onto financially sustainable footings. For these councils, the package includes strengthened Crown monitoring and intervention powers. It will also be important to monitor and evaluate implementation of the proposals and councils' responses to them. This risk is discussed further in section 3.

The policy proposals take into account the interaction with the preliminary arrangements

54. At the time of writing, Bill 2 has been introduced. As noted above, Bill 2:
 - provides a framework for councils to self-determine future service delivery arrangements via a Water Services Delivery Plan
 - steps towards future economic regulation
 - streamlines requirements for establishing water services CCOs under the LGA to enable councils to start shifting the delivery of water services into more financially sustainable configurations, should they wish to do so, and
 - includes provisions that enable a new financially sustainable model for Watercare.

55. Given the timing of the Bill, and the interconnectedness with the proposals in this RIS (and associated Cabinet paper), it is assumed throughout the analysis that the Bill will pass – creating the counterfactual in the analysis.
56. However, as this Bill has only just been introduced, the outcomes of the preliminary arrangements that this bill provides for, including the Water Service Delivery Plans, is not yet known. It has been assumed that these arrangements will be effective and fit for purpose – but this remains uncertain. Further, it is not yet known the extent to which councils will be capable of preparing effective Water Services Delivery Plans.
57. This also means that policy proposals have been developed without knowing the content of council Water Service Delivery Plans that will be required by Bill 2 once enacted.

No change to council-led relationships

58. The proposals assume that councils will continue to lead their local relationships with Māori, including ensuring that the process and content of their proposals meet their Treaty settlement obligations.

There are further policy proposals to come

59. As noted above, there will be two rounds of policy proposals for Bill 3– with the first set being assessed in this RIS. This means that assessments of proposals have had to be made in isolation of the more detailed proposals to come, without the ability to see the overall impact and interconnectedness.
60. However, this can be further drawn out in the further RIS which will accompany the second set of policy decisions.

There has been a reliance on analysis done as part of the previous Government’s reform programme as part of the assessment of proposals

61. As with the problem definition, analysis of these policy options was completed at pace to meet the required legislative timelines set by the Minister of Local Government to build the regulatory environment to support Bill 3.
62. Some analysis relies on work completed as part of the previous Government’s reform (including the Affordable Waters Programme). The Department recognises that some significant step changes have occurred within the water services delivery system since the previous Regulatory Impact Statements were drafted, such as the implementation of the Water Services Act 2021 by Taumata Arowai and the repeal of the Water Services Entities Act 2022.
63. However, the previous reform included a significant amount of consultation – both at the exploratory problem definition phase during the Three Waters Review and during the design of the reform. Where relevant, the Department has considered feedback collected during these work programmes for the analysis of proposals.

There has been limited consultation and engagement with stakeholders and interested parties

64. The Government’s proposals for reform were clearly signalled in election manifestos and coalition agreements. As with the first RIS, due to the legislative timeframes and Ministerial direction, there has been limited consultation with stakeholders during the overall policy design process. This includes with sector organisations, councils, iwi and hapū, and other interest groups.

- 65. However, there has been some engagement with several councils on these proposals, including delivery arrangements. The intent of LWDW is to enable councils to choose water services arrangements that best suit their needs, provided the arrangements meet minimum requirements, particularly financial sustainability requirements and regulatory standards. Engagement with councils has focussed on understanding what councils are intending to do with their future water services arrangements, and testing whether policy proposals would enable these. Further engagement is anticipated as councils commence their Water Services Delivery Plans once Bill 2 is enacted and when guidance material is made available.
- 66. As such, there are no views of councils outlined in this RIS. However, engagement with councils on the specific policy proposals and direction of LWDW has informed the analysis of Strategic Options.
- 67. While there has also been limited engagement with Māori to date, the Department is progressing a targeted engagement process with Māori, including with settled iwi, to ensure the potential impacts of LWDW on existing Treaty settlements are understood.
- 68. Officials have relied on:
 - the Government’s newly established Technical Advisory Group (TAG), who provided policy design input into the proposals included in this RIS, and
 - evidence and insights collected through the public consultation from the previous policy and legislative programme – which was extensive,
 - insights provided from the limited engagement with councils that has occurred.
- 69. TAG feedback is detailed alongside each policy proposal.
- 70. The Department had access to submissions made to Parliamentary select committees in their consideration of the previous Government’s various bills to provide for its water services reforms.
- 71. 9(2)(g)(i) [Redacted]
- 72. It is important to note the proposals are enabling for any arrangements that meet minimum requirements. Therefore, engagement that has occurred has focused on understanding what different groups of councils are wanting to do and making sure the policy settings would enable these proposals where they appear to fit the objectives of LWDW. This has also helped to get a better understanding of the support councils may require to develop their plans and move to future arrangements.
- 73. Further, in pursuing options to better deliver water services, councils will continue to have requirements to consult with their communities on how to achieve better delivery of water services. It is also expected that councils will be engaging with their local iwi and hapū, particularly given they have existing relationships, on the service delivery proposals they may wish to take forward.

The assessment of costs and benefits has had to rely on qualitative information

- 74. Due to constrained timeframes, data limitations and uncertainty as to how the various proposals will be implemented and responded to by councils it was not possible to

complete a full analysis of the costs and benefits of the four proposals beyond mainly qualitative estimates.

75. The assessment of costs and benefits should be considered as indicative only.
76. This has meant that the true costs and benefits, including those to be faced by councils, are not fully known. These costs will depend on how economic and other regulation is implemented by the Commission and others, and the capability and capacity of different councils to respond to the requirements of new regulation, including to achieve financial ringfencing of water services and to establish more efficient delivery models for water services.
77. This uncertainty about actual costs and benefits means there are risks that some councils may not meet the policy objective of delivering financially sustainable water services. Measures to monitor and address these risks are outlined in Section 3.

Treaty of Waitangi and Treaty settlement obligations

78. The LGA requires local authorities to facilitate Māori participation in decision-making processes within local government. The relationships, rights and interests that Māori have with local authority-provided drinking water, wastewater and stormwater services are often geographically or catchment specific and recognised at a local level, in agreements between mana whenua and councils.
79. Across the proposals, it is intended that existing obligations under the Treaty of Waitangi and Treaty settlements for councils and CCOs and council-controlled trading organisations (CCTOs) under existing legislation will continue to apply, regardless of the service delivery vehicle chosen by councils as their future model for water services delivery. No proposals are made to change these existing obligations. The proposals assume that councils will continue to lead their local relationships with Māori, including ensuring that the process and content of their proposals meet their Treaty settlement obligations.
80. Options in this RIS relating to a proposed streamlined processes for consultation and decision-making would be clear that existing requirements in the LGA relating to the contribution to decision-making processes by Māori, and processes for consulting with Māori, would continue to apply unaltered.
81. The Government has made commitments to do further work to rebalance the national policy statement for freshwater management (NPS-FM) and revisions to the (RMA) and the planning system, led by the Ministry for the Environment. The Ministry for the Environment has conducted limited engagement with iwi/Māori on the Government's intent for initial changes to the RMA. Any engagement by the Ministry for the Environment would be the appropriate mechanism to lead consultation on Māori rights and interests in freshwater management.
82. To the best of our knowledge, the amendments contained in this RIS do not impact or cut across the commitments made to iwi/Māori relating to freshwater or the resource management process.

There is a commitment in these reforms to upholding Treaty settlements.

83. As noted above, there has been limited engagement with iwi/Māori to date. As such, it has not been possible to fully assess the impacts of the proposals on the Crown's Treaty obligations or Treaty settlement commitments.
84. The Department has committed to working with Treaty settlement specialists and Post Settlement Governance Entities (PSGEs) to undertake further analysis to understand

potential implications of the impacts of these proposals on Treaty settlements, noting that an objective of the reforms is to uphold existing Treaty settlements.

85. In addition, the Minister of Local Government has asked the Department to continue to engage with iwi/Māori and PSGEs to ensure the potential impacts of LWDW on Māori interests are understood (noting that iwi/Māori have documented interests arising from Treaty settlements, current joint planning and decision-making arrangements with councils, and a demonstrated and ongoing commitment to address their rights and interests in freshwater).
86. Further work in this area is continuing and will inform further work on Bill 3, including the next set of policy decisions.

Assessment

87. The Crown is expected to act consistently with the principles of the Treaty of Waitangi, including the principles of partnership, participation and active protection.
88. It is noted that, while the proposals do not seek to change existing obligations that councils already have (as described above), it is difficult to be definitive as to whether Treaty principles and Treaty settlement commitments have been met, for reasons including:
 - The limited engagement with Māori to date, but a commitment that further analysis on and engagement on Treaty settlement implications and engagement with Māori will occur, noting that further decisions in a second stage on Bill 3 are yet to be made and the proposals across those decisions are inter-connected.
 - The fact that further decisions in a second stage on Bill 3 are yet to come, and as a whole will shape the assessment of consistency with Treaty obligations.
 - Isolating the precise relationship of water services reform to iwi/ Māori rights and interests in freshwater is difficult. There is uncertainty about the potential impacts of the changes addressed here. In addition, those impacts are largely driven by other policy reform areas not addressed by this RIS.
89. There is a risk that taking decisions before engagement is fully completed will impact on the ability of the Crown to meet Treaty obligations, for example - if decisions are pre-determined. It is difficult to assess this risk given the Department's intention to engage further before final decisions are taken on the content of Bill 3.
90. Treaty implications will be reviewed across the whole package of policy proposals as part of the next set of policy advice and RIS.
91. As noted above, there are significant intersects between these proposals and the next set of policy proposals to come. These collectively will form the longer-term enduring framework for water services. As such, the Treaty impacts will be considered across the whole package of proposals at that stage and prior to the introduction of the final Bill.
92. Further work is ongoing in relation to Treaty settlements analysis and engagement.

Section 2: Deciding upon an option to address the policy problem

What strategic options could the Government explore?

93. As noted in the first RIS, there are four broad approaches (Strategic Options) available to the Government as it considers what it can do to enable and support local authorities to deliver water services that are financially sustainable and meet minimum regulated quality standards:
- **Strategic Option One:** Status quo, being reliance on the current provisions of the LGA to provide for council accountability in financial management and delivery of water services, and current regulatory settings
 - **Strategic Option Two:** Transitional provisions to focus councils on the sustainable financial delivery of their water services, inform development and implementation of economic regulation and prepare councils for full economic regulation
 - **Strategic Option Three:** Economic regulation without transitional provisions
 - **Strategic Option Four:** Economic regulation coupled with stronger direction from central government to councils on how to manage and organise their delivery of water services.
94. The four Strategic Options were assessed in the first RIS, with the Department recommending **Strategic Option Two** as it aligns with LWDW and provides the necessary incentives and support for councils to improve delivery of their water services in the lead up to full economic regulation.
95. Strategic Option Two aimed to enable council reorganisation of water services in the lead up to economic regulation. A combination of four key proposals (outlined below) would ensure council focus on what is needed to put their water services onto sustainable financial footings as a basis for their transition to full economic regulation in the future. They will focus councils on the sustainable financial delivery of their water services and inform the development and implementation of economic regulation.
96. The four proposals are:
- greater information disclosure to inform the regulatory regimes
 - systems to require councils deliver financially sustainable water services that meet regulatory standards
 - legislative amendments to streamline the establishment of new water services CCOs
 - explore options for the financial separation for Watercare.
97. Economic regulation promotes positive outcomes for customers but requires a long implementation process. This option allows for a transitional economic regulation period in which the economic regulator will be able to work with the water sector to build its understanding of how to comply with economic regulation. The establishment of an economic regulator also takes time and resource. Central government will need to communicate with and educate councils on the regulatory requirements.
98. Strategic Option Two will also support all councils, regardless of their capability to prepare for economic regulation. For example, it should support suppliers that are

ready to move to a stronger regulatory environment and suppliers that will need to gradually shift their mode of delivery to clearer planning through a roadmap and provide greater accountability to their communities.

99. It will also ensure that all councils are focussed on what they need to do and change to put their water services onto financially sustainable footing in the years prior to the full implementation of economic regulation. For councils unable to adequately respond to the requirements of economic regulation proposals are considered later in this RIS for the enhanced monitoring and supervision of councils in their delivery of water services.

What criteria will be used to compare options to the status quo?

100. The first RIS set out six criteria against which both the Strategic Options and four Policy Proposals were assessed against.
101. This RIS builds on this set of criteria. It continues to provide a link between policy options and the Government’s reform objectives. The criteria provide the basis to indicate the extent to which each option will result in changes to councils’ delivery of water services to improve their financial sustainability in order to better meet community quality expectations of those services.
102. However, there have been two main adjustments:
- The description, and relevance to objectives and root causes, have been amended to explicitly draw out the judgments and decisions needed across the proposals in this RIS, and associated Cabinet paper.
 - The criteria, ‘enables Māori participation in decision-making’ has been removed. This was originally intended to assess the extent to which an option enables Māori participation in decision-making that reflects the nature of their rights and interests in freshwater management and provision of water services to communities. This criteria is considered more appropriate for the options in the prior RIS – the options in this RIS do not lend themselves as well to each being considered against this criteria. Accordingly, this RIS includes a stand-alone section on Treaty obligations instead (above).

Table 1: Revised criteria descriptions

Criteria	Description	Relevance to objectives and root causes
Improved incentives, efficiency and accountability for sustainable performance	The extent to which an option supports a more transparent, efficient, and accountable system that drives better decision making and improved performance for all councils, while providing flexibility. This includes the extent to which an option supports the remedy of underperformance.	Incentives and accountability are critical to the success of a locally-led approach to delivery. The problem definition concludes that current incentives on council management of water services are not well aligned to achieving the sustainable financial management of long-life water services assets. It also concludes that communities do not have access to transparent and reliable information to hold councils to account for their performance in delivering water services. The problem definition also points to how a lack of economic regulation contributes to weak incentives and accountability. Institutional barriers to exploring and implementing more efficient organisational approaches to water services delivery are compounded by incentives on councils to be risk averse.

Criteria	Description	Relevance to objectives and root causes
Improved evidence-base to inform delivery decisions	The extent to which an option supports faster and more sustainable investment from water services providers in water services infrastructure.	Water services networks and infrastructure are complex and expensive long-life assets. Good information and capable decision making and governance are supported by strong evidence, which is critical to sustainable financial management. The problem definition concludes that management of water services is not always informed by good evidence and that councils may not always have the capabilities they need to provide effective governance.
Provides a financially sustainable approach for local council delivery of water services	The extent to which an option addresses the ability of water services providers to use a range of tools to fund and finance investment to ensure their financial sustainability. This includes the extent to which an option provides for the financial separation of water services, including increased access to debt financing.	This criterion aligns to the overarching objective and is intended to provide for an overall assessment of the effectiveness of an option in providing for improved financially sustainable delivery of water services. The problem definition identifies funding constraints as being critical to financial sustainability and meeting minimum quality standards for communities, and this criterion will include consideration of the extent to which each option addresses these constraints. This criteria also relates to the removal of institutional barriers to the more effective financial management of water services, including the role that financial ringfencing can play as one way to address funding constraints by providing for increased debt financing of water services through their balance sheet separation from other council activities and functions.
Enables improved quality, resilience, and residential growth	The extent to which an option supports future resilience (across a range of external pressures) and quality of water services delivery whereby growth is not inhibited.	This criterion also aligns to the overarching objective and is intended to provide for an overall assessment of the effectiveness of an option in providing for improved quality outcomes in local provision of water services.
Provides a practical path for implementation	The extent to which an option allows for a smooth transition to a new system. This is in a way that provides clarity to councils on what to expect and predict when responding to regulatory changes. This also includes the extent to which options recognise different capacities and capabilities to effectively respond to new regulatory requirements.	This criterion has been included to assess the practicality of each option as a basis for its successful implementation. Part of this is recognising the different starting points of councils, and the need to ensure that regulatory and other proposals are proportionate to council capability and capacity to effectively respond, and also for requirements to change over time as capability and capacity improves.

What scope will options be considered within?

103. Building on the four proposals already assessed in the first RIS under Strategic Option Four, this RIS provides for **four additional proposals** that start to set the enduring foundations within the water services delivery sector to transition to full economic regulation.
104. These proposals sit across four areas:
- Optionality for water services organisations
 - Minimum requirements for financial separation
 - Introduction of economic regulation
 - Assistance and intervention framework.
105. The Department is the policy lead on proposals 1,2 and 4. MBIE is the lead for proposal 3 – economic regulation.
106. These are the first set of policy proposals for inclusion in Bill 3, with a further set to come.

While assessed separately, the proposals come together as a package and have a high degree of interdependency

107. Across all of these proposals, there is significant overlap as they come together to form the LWDW ecosystem.
108. In particular it should be noted that:
- proposals for economic regulation and financial ringfencing are critical to setting long-term expectations for councils' financially sustainable delivery of water services
 - proposals for optionality in how councils choose to deliver water services provide means for councils to respond to the incentives of economic regulation
 - proposals for oversight of councils' delivery of water services provide for intervention in cases that councils are unable to achieve the financially sustainable delivery of water services.
109. To this end there is a high interdependency between the different proposals and government's objective to improve council delivery of water services.

The counterfactual options include the proposals set out in the Local Government (Water Services Preliminary Arrangements) Bill

110. As noted in Section 1, the preliminary arrangements were agreed by Cabinet in March 2024, with the intention to introduce and pass legislation (Bill 2) by August 2024 that will establish a framework and preliminary arrangements for the new water services system. These arrangements, and proposals, will cause the regulatory landscape to adjust over the next six months.
111. It has therefore been assumed that these arrangements form part of the 'counterfactual'.

Policy options are informed by, and limited to Government policy

112. As outlined in Section 1, the policy proposals are informed by, and limited to, Government policy. This includes key parameters set out in within LWDW, including that:

- councils will retain ownership and control of their water services assets and delivery
- central government will have stronger oversight to ensure that the status quo does not continue, including introducing an economic regulator
- councils will be required to ringfence assets and funds for water infrastructure with the policy objective that water services will become financially sustainable, and
- there is greater transparency and accountability to consumers, communities and regulators.

113. Therefore, options such as compulsory amalgamation of council owned water organisations which were progressed under the previous government, are not assessed.

Proposal One: Optionality of water service provider models for councils

114. Three options are explored below:

- **Option One:** Current set of available water service provider options set out in legislation, including transitional consultation provisions provided for in Bill 2 (counterfactual)
- **Option Two:** Legislative change to enable a broad range of water service providers, with clear minimum requirements (the Department's preferred approach)
- **Option Three:** Legislative change to enable new water services providers with clear minimum requirements (as per Option Two), but council choice is restricted to specified models.

Option One – Current set of available water service providers options set out in legislation, including transitional consultation provisions provided for in Bill 2 (counterfactual)

115. Under this option councils are able to decide how they undertake the delivery of water services; however, their choices continue to be restricted to current delivery models as enabled under the LGA. This includes:

- direct delivery by councils – with services provided 'in house' (for example, as discrete business units)
- CCOs and CCTOs owned by single or multiple councils, as per the LGA.

116. This option includes the transitional arrangements set out in Bill 2, which both provides for both Water Services Delivery Plans and transitional arrangements to streamline the process for establishing new water services CCOs.

117. Under this option, two or more councils who are wanting to form a joint water services CCO can set up a joint committee. The joint committee's scope includes analysis of options, recommending a preferred option/proposal to the participating councils, undertaking consultation on the proposal (if approved by all councils) in a joint manner, and making final recommendations to the participating councils on whether to establish the joint CCO. The transitional arrangements clarify the minimum requirements for consultation, modify information requirements and considerations in the decision-making process. The modified factors that the joint committee and councils could include in their decision making would serve to 'de-risk' the process for councils who are concerned about the possibility of judicial review if they are seen to, as part of the consultation and decision-making process, consider for example, the wider impacts of a CCO rather than just on their individual district.

118. Under this option, planning and accountability would be set out as currently in the LGA, which means that there would only be very basic provisions for planning and reporting for CCO/CCTOs, and councils would continue to be responsible for planning and reporting in relation to water services (and to do so in documents that cover other activities).

119. Under this option, some councils would continue to struggle to reliably raise the finance needed for adequate investment in water services.

Option Two – Legislative change to enable a broad range of water service providers, with clear minimum requirements (the Department's preferred approach)

120. This option would include legislative change to provide for an expanded range of water service providers for councils to choose from. Councils could also be able to develop alternative models, provided these meet minimum specified requirements.
121. This option provides councils with a great degree of flexibility on how they may want to organise their water assets to meet local needs and circumstances.
122. The range of water service providers could include (but are not limited to):
 - direct delivery by councils – with services provided ‘in house’ (for example, as discrete business units)
 - separate water organisations, which could include:
 - CCOs and CCTOs owned by single or multiple councils, building on models currently in the LGA
 - organisations owned by multiple councils, which are intended to be financially independent from a credit rating perspective
 - new consumer trust-owned and mixed ownership (council/trust-owned) organisations, which are intended to be financially independent from a credit rating perspective.
123. Councils could enter into long-term contracts with third-party providers to outsource the delivery of some or all water services.
124. Guidance would be provided on the range of options available to councils, and to support councils’ assessment of which providers are most appropriate for their circumstances.
125. In making their choices, councils will decide on whether to retain direct delivery over some or all water services, or to transfer drinking water, wastewater and/or stormwater services to specialist water organisations that they might directly establish or establish with other councils. In deciding how to organise and deliver their water services, councils would continue to be responsible for consulting with their communities.

Minimum requirements for water service providers

126. Across all water service providers there are minimum requirements that could be set out in legislation to ensure a degree of consistency across the range of vehicles, including that all local government water services providers:
 - will be subject to economic, environmental and water quality regulation
 - will be subject to a bespoke planning and accountability framework for water services
 - must be financially sustainable
 - must act consistently with statutory objectives, and
 - will be subject to restrictions against privatisation.

Wider requirements for water organisations

127. Legislation would set out additional requirements for water organisations relating to ownership, governance and structural arrangements. This includes new provisions, and enhancements to the current provisions in the LGA for CCOs and CCTOs that deliver water services – to ensure these are fit for purpose.

128. The legislation would also set out governance and organisational requirements for water service providers, including:
- that water service providers boards must be independent and governed professionally
 - prohibition on appointment of current council staff and elected members to water service providers' boards
 - that water service providers must be companies (and thus governed by the Companies Act 1993)
 - ownership and management arrangements for water assets
 - restrict scope of water service providers activities to water services only
 - alternative consultation and decision-making requirements
 - provisions to support the transfer of assets, liabilities, and employees to new water service providers.
129. The legislation would also set out additional provisions for consumer trust-owned and mixed-ownership organisations, including:
- restrictions on the transferability of ownership interests
 - the consumer trust must represent the water service provider's consumers and their interests,
 - consumer trustees will be elected by local consumers, and will be responsible for appointing and removing board members and overseeing performance, and
 - consumer trust shareholding arrangements.
130. **Annex One** provides a summary of water service providers.

Planning and accountability

131. Under this option, a planning and accountability framework will also be provided for in the legislation, which is specifically designed for the water service providers outlined in this option. However, it would not apply to other kinds of provider (such as Crown or private providers).
132. It would be separated and distinct from the general LGA planning and reporting framework, which accommodates a wider range of outcomes and activities. It would also apply instead of the general provisions that relate to CCOs/CCTOs.
133. This planning and reporting framework would have three core components to form the basis of an accountability cycle:
- **Statement of expectations** - to be prepared by owners/shareholders and issued to (non-council) water service providers (for models other than council direct delivery). This would set out the expectations, priorities, strategic direction, and outcomes for the provider, and inform and guide the decisions and actions of its board. Water organisations would be required to give effect to this statement.
 - **A Water Services Strategy** - to be prepared by water service providers. This would be the primary accountability document, and which would set out how the provider is proposing to respond to local priorities (including matters in the

statement of expectations) and meet regulatory and financial sustainability requirements. It would be the basis for assessing performance.

- **Annual report** - to be prepared by water service providers. This would report on performance against the expectations and proposals in the above documents, and standard financial reporting (which would be audited).

Option Three – Legislative change to enable new water service providers with clear minimum requirements (as per Option Two), but council choice is restricted to specified models.

134. Under this option, councils would be required to adopt specified classes of water service providers as outlined in legislation. This is likely to be one of the options specified in Option Two (paragraph 122 above), or a smaller or more specified list.
135. Unlike Option Two, councils would not have an open choice of water service providers to choose from. Nor would they have the option to modify a specified provider or develop an alternative service delivery model to those provided in legislation. This would enable government to set and enforce clear requirements for how council's deliver water services to ensure use of models that achieve sustainability and are conducive to improved financial performance and efficiency, but at the cost of local choice.
136. Further, expectations could be set in terms of which water service providers councils should move to – removing flexibility and choice. For example, councils could be directed into multi-council owned water service providers that have the potential to achieve economies of scale and enable better access to financing.
137. As such, there would be stronger legislative powers for central government and the Minister to direct councils in how they are to manage and organise delivery of water services, and less flexibility for councils to determine which service delivery model can be used. This could occur through inclusion of a power that would allow the Minister to prescribe in regulation organisational types or features that particular councils with particular characteristics or in particular circumstances would be required to adopt in their delivery of water services. These characteristics or circumstances could relate to matters such as the size of the population served or the value or state of the water services asset base and its management.
138. Therefore, the two main differences from Option Two, are that:
 - councils will not be able to choose alternative water service providers, and
 - Government may direct councils in how they are to manage and organise the delivery of water services.
139. As in Option Two, all water service providers would be subject to minimum requirements set out in legislation.
140. Under both options two and three, councils will benefit from improved central direction and requirements to inform their delivery of water services and additional organisational options that will improve their ability to achieve the financial sustainability of their water services and to raise the finance needed for adequate investment in water services.

How do the options compare to the counterfactual?

	Option One – Current set of available water service providers options set out in legislation, including transitional consultation provisions provided for in Bill 2 (counterfactual)	Option Two – Legislative change to enable a broad range of water service providers, with clear minimum requirements (the Department’s preferred approach)	Option Three – Legislative change to enable new water service providers with clear minimum requirements (as per Option Two), but council choice is restricted to specified models
Improved incentives, efficiency and accountability for sustainable performance	<p>0</p> <p>Councils have the ability to deliver water services through direct provision or CCOs/CCTOs. While this option provides for the streamlining of processes for establishing water services CCOs, including barriers for establishing joint services with other councils, it does not provide for other vehicles to be established by councils.</p>	<p>+</p> <p>Depends on the choices councils make on delivery vehicles. The framework provides for a greater span of options including those that will better improve incentives and efficiencies, although there will be a trade off with community accountability in arms-length vehicles. Provides for a range of vehicles that will give councils access to the most appropriate option for their specific circumstances.</p>	<p>+</p> <p>Councils will be pushed towards more effective models than the status quo. However, it may push councils towards a set of options that may not be viable in their current form and takes away flexibility and choice. There is also less risk of councils being excluded from a regional organisation. These are councils that, because of large investment requirements and/or liabilities, are not desirable partners in the establishment of multi-council organisations.</p>
Improved evidence-base to inform delivery decisions	<p>0</p> <p>Accountability and decision-making through LTP amendments and consultation is still required via the LGA. Councils would also have a clearer statutory process to explore water services CCOs, which should reduce the barriers (perceived or real) associated with potential for judicial review.</p>	<p>+</p> <p>Governance and organisational requirements for water service providers (such as the independence and professionalism of boards, and ownership and management arrangements for water assets) supports more sustainable investment. Further the planning and accountability changes will bring in components such as the Water Services Strategy which brings together information to inform decisions.</p>	<p>+</p> <p>Governance and organisational requirements for water service providers (such as the independence and professionalism of boards, and ownership and management arrangements for water assets) supports more sustainable investment. Further, the planning and accountability changes will bring in components such as the Water Services Strategy which brings together information to inform decisions.</p>
Supports a financially sustainable approach for council delivery of water services	<p>0</p> <p>There will continue to be variations across councils on their performance. Some councils (particularly large urban councils) are likely to reach their debt caps as interest rates remain high. There is a risk that their credit ratings are downgraded, which will increase the cost of their debt repayments. Further, financially independent vehicles are not enabled in legislation, which limits council’s ability to achieve financial separation.</p>	<p>+</p> <p>While this depends on the delivery vehicle and the choices councils make, there is a requirement for councils to use arrangements that are more financially sustainable and meet regulatory requirements. For some councils, establishing a financially independent water service provider will enable better access to financing and long-term borrowing, enabling improved long-term investment in water services. The new range of models also provides for greater options that enable better financial separation of water services.</p>	<p>+</p> <p>Depending on the models prescribed, there could be a push towards a more financially independent model which is the best outcome for some councils. For some councils, establishing a financially independent water service providers will enable better access to financing and long-term borrowing, enabling improved long-term investment in water services.</p> <p>However, some councils may continue to be limited by their debt caps as interest rates remain high, limiting their ability for balance sheet separation. Without financial support from the Crown or alternative funding or financing tools, it is very likely that rates and user charges will continue to rise to</p>

	Option One – Current set of available water service providers options set out in legislation, including transitional consultation provisions provided for in Bill 2 (counterfactual)	Option Two – Legislative change to enable a broad range of water service providers, with clear minimum requirements (the Department’s preferred approach)	Option Three – Legislative change to enable new water service providers with clear minimum requirements (as per Option Two), but council choice is restricted to specified models
		However, some councils may continue to be limited in their capacity to borrow to invest in water services because of high existing debt levels and/or small rating/customer bases to service debt costs. For these councils, without the ability to realise scale efficiencies through amalgamation with other councils or additional financial support, it is very likely that rates and user charges will continue to rise and might be insufficient.	fund water investment.
Enables improved quality, resilience, and residential growth	0 This option is neutral with regards to improved quality, resilience and residential growth.	+ This option provides a wide range of solutions for councils; however, the outcomes do depend on which delivery vehicle is chosen.	+ This option provides a fixed number of “off the shelf” solutions for councils. The more limited choice of vehicles may push councils towards a solution that is not viable in their current form.
Provides a practical path for implementation	0 No additional implementation required.	+ Given the flexibility in this option, it enables councils to adjust to service delivery models that make sense in their local context, however this will require resources and funding from councils to implement changes.	- Depending on the prescribed models, this option may be relatively more costly for councils who are required to implement a different model from their current delivery approaches. This option does not provide for flexibility as councils tailor delivery approaches to their specific circumstances. Smaller councils in particular could find these shifts difficult to manage and would likely require specialist skills and resourcing. This option will also require resources and funding to implement changes.
Overall assessment	0	+	+

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

141. The Department recommends that Option Two, Legislative change to enable a broad range of water service providers, with clear minimum requirements.
142. Option Two is recommended because it:
- aligns with the objectives set out in LWDW and provides councils with the greatest flexibility to decide how they want to delivery water services to their communities
 - provides councils with a greater span of choice and options that can be tailored to different local characteristics, including delivery models that will better improve incentives and efficiency and enable the effective management and delivery of financially sustainable water services
 - provides councils with the option to either:
 - adopt a service delivery model provided for in the legislation, including for multi-council, consumer trust-owned and mixed ownership water organisations, or
 - develop their own water service providers that meets the legal minimum requirements and regulators standards.
143. These new vehicles enable councils to potentially achieve economies of scale, where that makes sense to achieve more efficient service delivery; and enable better access to financing for water services, including by facilitating long-term borrowing.
144. As part of the development of Proposal One and the preferred option, the Department has engaged with the TAG, MBIE and the Commission.
145. The TAG generally recommended taking an enabling legislative approach (as opposed to a prescriptive approach) for the service delivery vehicles. This is to provide flexibility to councils. The TAG also agreed that all service delivery vehicles should be subject to clear “bottom line” minimum requirements and regulatory standards.
146. Members of the TAG recommended there should not be a mandatory requirement in legislation for water service providers to produce governance documents such as constitutions or shareholder agreements. Given all water service providers will be required to operate as companies (and will therefore be subject to the Companies Act 1993), it is expected all water service providers will produce governance and establishment documents as part of good governance practice, including constitutions and shareholder agreements.

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups	A one-off front-end cost to councils to change or modify their delivery approach. However, depending on the effectiveness of the approach taken, this is expected to result in relative reductions in ongoing costs of providing water services compared to if councils were to continue with current arrangements. For many councils, this should mean that forecast increases in costs of providing water services will be lower than without change.	Medium	Low
Regulators	One-off cost to the Crown to complete legislative amendments.	Low	Medium
	Potential minor ongoing cost to the regulator to support understanding of changes across a large number of councils.	Low	High
Others (e.g., wider govt, consumers, etc.)	<p>The impacts for ratepayers and consumers will depend on the ability of councils to achieve efficiency gains through their reorganisation of water services. This will be sensitive to the organisation model chosen by council and second order decisions related to its governance, management, pricing and charging for services.</p> <p>Establishment of new water service providers will result in one-off costs (cost of consultation, potential establishment, water user charges).</p> <p>Depending on the model chosen, payment for water services may shift from being collected through rates to direct user charges. The approach taken to price setting and charging, including volumetric charging, may result in changes to what consumers pay for water services, and may also result in incentives on consumers to better manage use of water through (for instance) more prompt repair of leaks and less waste of water).</p> <p>Whether the total cost to consumers will increase or decrease will depend on the availability of new finance options, the historic infrastructure debts in area, and efficiency benefits for those organisations banding together to access economies of scale. To the extent that reorganisation and changes to management of water services results in efficiencies, it is expected that over the medium to long term the costs of water services to consumers will decrease relative to what they would be under the status quo.</p>	Medium	Low

Total monetised costs	<i>Not available at this point in time</i>	n/a	n/a
Non-monetised costs		Low/Medium	Medium
Additional benefits of the preferred option compared to taking no action			
Regulated groups	<p>Councils will benefit from improved access to delivery models that support more efficient service delivery, improved governance, and greater access to funding and financing.</p> <p>Financial separation of water services from other council services, will over time, result in more financial headroom for councils to invest in other council provided services.</p>	Medium	Low
Regulators	<p>The economic regulator will benefit from additional organisation models and clear minimum requirements for delivery of water services that provide for financial ringfencing of water services from other council services. Models and requirements that provide for financial ringfencing will make it more straightforward for the economic regulator to understand councils' delivery of water services and to assess efficiency and apply economic regulation to council water services providers.</p>	Low	Medium
Others (e.g., wider govt, consumers, etc.)	<p>Rate payers will benefit from greater transparency to assess the financial performance of their council in providing water services. To the extent that councils achieve efficiency gains through their reorganisation of water services and adoption of new water service provider models, rate payers and customers of water services will benefit over time from relative reductions in rates or direct user changes for water services compared to what they would pay under the status quo. Ratepayers might also benefit from increased council investments in other services, made possible from the financial separation of water services.</p> <p>Consumers of water services will benefit from improved quality of services or lower long-term prices than they would otherwise pay as a result of efficiency gains from the reorganisation and improved management of water services.</p> <p>Depending on approaches taken to pricing of water services, consumers may benefit from approaches to pricing of water service that better reflect demand on services.</p> <p>To the extent that improved approaches to management of water services result in less wastage of water, consumers, farmers and others may benefit from less demand on</p>	Low	Low

	source water sources. Water not wasted through leaks will be available to the environment of for other economic uses.		
Total monetised benefits	<i>Not available at this point in time</i>	n/a	n/a
Non-monetised benefits		<i>Low</i>	<i>Low/Medium</i>

Proposal Two: Minimum requirements for financial separation

147. Three options are explored below:

- **Option One** – No explicit ringfencing requirements (status quo)
- **Option Two** – Stand-alone financial statements are required for water supply, wastewater, stormwater, and the three waters in aggregate (the Department's preferred approach)
- **Option Three** – Hypothecation of water revenues under specific circumstances (the Department's preferred approach).

Option One – No explicit ringfencing requirements

148. Financial information on water services is already included in council planning and reporting documents under the LGA and Local Government (Financial Reporting and Prudence) Regulations 2014 (through funding impact statements). Although funding impact statements do not require disclosure of borrowings or cash reserves, which means there is no current reporting requirement to demonstrate that all cash generated from water service revenues is used for water service expenditure.

149. Stand-alone service delivery models such as CCOs, will deliver ringfencing at an aggregated level by operating water services at arms-length from other council business.

150. As part of the transitional provisions set out in the Bill 2, councils will be required to develop Water Services Delivery Plans which aim to ensure that each council is focused on what it needs to do to transition delivery of their water services onto a financially sustainable footing. These Water Services Delivery Plans will cover council priorities and proposals to achieve financially sustainable delivery of water services – including the proposed organisational delivery model (on an individual basis or joint with other councils). They will also cover funding and pricing and the planned approach to funding water services – including details of user charges, borrowing and approaches to debt management (including any plans to increase debt headroom through financial separation from councils).

151. No explicit ringfencing requirements still provides a degree of financial transparency and financial separation of water services. However, this may not be achieved for councils who continue to deliver water services in-house.

Option Two – Stand-alone financial statements are required for water supply, wastewater, stormwater, and the three waters in aggregate (preferred approach)

152. Under this option, there would be stand-alone financial statements to report water supply, wastewater, stormwater³, and the three waters in aggregate.

153. Water services financial statements will:

- include all revenue and expenditure relating to the specified water service
- be compliant with Generally Accepted Accounting Principles, and
- include a statement of profit and loss, balance sheet and statement of cash flows.

³ With regards to stormwater, the Commerce Commission's monitoring and enforcement role of this would apply if/when stormwater is brought into the economic regulation regime and becomes a regulated service.

154. Financial statements prepared would need to be consistent and reconcilable with funding impact statements for water services, to ensure that water services activities are transparently presented.
155. Councils will need to track and report on all cash borrowed and generated for water services as well as the uses of cash to prepare stand-alone financial statements. This requires any unspent revenues or cash generated to be retained and tagged for future water services expenditure or activity.
156. Ringfencing principles will also be set out in the legislation to guide water service providers and the additional rules, guidance and performance requirements that may be set by the Commission (as a part of the fulsome economic regulation). The principles would include:
 - water revenues must be spent on water services; and
 - water service charges and expenses must be transparent and accountable.
157. This aims to provide transparency and accountability over the amount of council debt that is allocated to water services. It will also assist with the determination of whether water services revenues are set at financially sustainable levels.

Option Three – Hypothecation of water revenues under specific circumstances

158. Under this option, there would be the hypothecation of water revenues under specific circumstances. This means that revenues or cash generated for water services cannot be used for other purposes. This allows for increased certainty and lower risk to investors.
159. This could include requiring a portion of water revenues to be invested in a certain asset, expense category, project, programme, type of regulated water service or held in reserve. While it is possible that this could be set across all regulated water services, it more likely that the economic regulator would take a selective approach to its use, and use it as part of a package of interventions available to it in particular circumstances when needed.
160. Under this option, the Commission would be able to set and enforce hypothecation requirements. The hypothecation of revenue would be a tool available to the Commission if it identified underlying issues with the performance of a water network. The Commission would be able to make a recommendation to the Minister of Commerce and Consumer Affairs that a water service provider should become subject to performance requirements if the Commission considers that the application of this tool is in the long-term benefit of water services consumers. This is discussed further as part of Proposal Three below.

How do the options compare to the status quo?

	Option One – No explicit ringfencing requirements	Option Two – Stand-alone financial statements are required for water supply, wastewater, stormwater and the three waters in aggregate (the Department’s preferred approach)	Option Three – Hypothecation of water revenues under specific circumstances (the Department’s preferred approach)
Improved incentives, efficiency and accountability for sustainable performance	<p>0</p> <p>Financial information on water services is already included in council planning and reporting documents under the LGA and Local Government (Financial Reporting and Prudence) Regulations 2014.</p>	<p>+</p> <p>Would materially improve the transparency of water service charges and expenditure as water functions would be notionally represented as a stand-alone business, separate from other council business. Further, councils will need to track and report on all cash generated for water services as well as the uses of cash to prepare stand-alone financial statements, improving incentives and efficiency.</p>	<p>+</p> <p>Would materially improve transparency, accountability, and compliance with legal requirements and policy.</p>
Improved evidence-base to inform delivery decisions	<p>No improvement on current requirements.</p>	<p>+</p> <p>The requirement for standalone accounts would segregate financial data to facilitate analysis and reporting specifically on water services as separate and distinct to all council business – allowing for more informed and sustainable decision-making. It will also include the development of financial policies that govern how water services operate distinct from other council business.</p>	<p>Would provide additional transparency and information related to specified aspects of water services operation.</p>
Supports a financially sustainable approach for council delivery of water services	<p>0</p> <p>Persistence of large variations across councils on their financial performance.</p> <p>Does not ensure water revenues are spent on water services. The increased financial pressures to invest in and maintain water infrastructure may mean that councils are making trade-offs between water and other services or projects.</p>	<p>+</p> <p>As well as segregating financial data, this option would require accounts to ‘balance’ meaning that water revenues and cash generated must flow through to uses and require councils to develop a set of financial policies that govern how water services operate distinct from other council business.</p> <p>This option would also increase transparency through stand-alone accounts to show where cash generated from water revenues flows. However, it alone does not directly increase access to finance as this will depend on a range of governance and operational practices specific to each water service.</p>	<p>++</p> <p>Under this option, specific revenue streams would be earmarked for designated purposes, such as financing projects or activities. It ensures that these funds are dedicated to particular uses and cannot be diverted for other expenses. In the context of water services, this could mean that all water revenues are required to be spent on water services.</p> <p>By legally requiring water revenues to be spent on water services and frees up balance sheets and allows them to borrow more money for water.</p>

	Option One – No explicit ringfencing requirements	Option Two – Stand-alone financial statements are required for water supply, wastewater, stormwater and the three waters in aggregate (the Department's preferred approach)	Option Three – Hypothecation of water revenues under specific circumstances (the Department's preferred approach)
Enables improved quality, resilience, and residential growth	<p>0</p> <p>The increased financial pressures to invest in and maintain water infrastructure may mean that councils are making trade-offs between other services or projects, meaning there is less resilience to future shocks or extreme events, or planning towards growth.</p> <p>Councils are likely to focus on water infrastructure delivery as the system reaches crisis levels. Councils may need to invest in their infrastructure reactively to meet these pressing needs, while deferring other projects to make savings needed for water investment.</p>	<p>+</p> <p>This is only one tool that can support growth; however this option would ensure that analysis and reporting specifically on water services are separate and distinct to all council business and is prioritised and requires councils to develop a set of financial policies that govern how water services functions operate distinct from other council business.</p> <p>Dedicated investment in water infrastructure will mean higher levels of resilience compared to the status quo.</p>	<p>+</p> <p>Hypothecation means that specific revenue streams would be earmarked for designated purposes, such as financing projects or activities. This ensures that long-term these funds are dedicated to particular uses and cannot be diverted for other expenses.</p> <p>This option also enables the Commission to address challenges with under-recovery and underinvestment.</p>
Provides a practical path for implementation	<p>0</p> <p>No implementation required.</p>	<p>+</p> <p>Effort required to develop/refine financial and operating policies, set up governance over the arrangement, and to implement changes to accounting systems. There would also be the need to determine opening balances for the balance sheet, which would likely be a more significant task for larger councils with more complex operations.</p>	<p>+</p> <p>The implementation depends on how the Commission sets and enforces hypothecation requirements and how many water service providers these impact.</p> <p>Detailed financial and operating policies will need to be established, with legal and governance oversight over arrangements. This could be overly burdensome on some councils.</p> <p>However, it is not expected that this will apply to a large number of water service providers.</p>
Overall assessment	0	+	++

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

161. The Department recommends that Options Two and Three be progressed as a package. This means that both the development of stand-alone financial statements, as well as the hypothecation of water revenues are enabled in legislation.
162. These ringfencing proposals will:
 - transparently disclose the true cost of water services delivery and infrastructure investment and whether revenues are sufficient to cover costs (i.e. revenue sufficiency)
 - provide a proxy for operational and financial separation of water services from other council business
 - enable a clear determination as to whether proposed revenues and costs in delivering water services operations are financially sustainable
 - reinforce and clarify expectations for councils and their organisations around financial sustainability
 - enable management and governance to have an appropriate level of oversight of water services revenue and costs, and assist with investment and financing planning
 - support the economic regulator through more transparent disclosure, which will help to ensure that adequate investment occurs in the water network, in order for it to meet its performance requirements.
163. The hypothecation of water revenues under specific circumstances provides the Commission with another tool to address issues, such as under-recovery and underinvestment. This provides a mechanism for the regulator to ensure that adequate investment occurs in the water network, for it to meet its performance requirements.
164. As part of the development of Proposals Two and Three, the Department has engaged with the TAG, MBIE, and the Commission.

What are the marginal costs and benefits of the option?

Affected groups (identify)	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups	There could be one-off costs for setting up new accounting systems for some water service providers. Ongoing reporting costs for complying with GAAP rules for preparing financial statements are expected to be minor.	Low	Medium – New requirements aren't bespoke - GAAP compliant financial statements are standard practice for any listed company.
Regulators	Financial statements create ongoing monitoring costs. These are expected to be minor.	Low	Medium
Others (e.g. wider Government, consumers etc.)	Regulated parties are expected to pass costs on to water consumers.	Low	Medium
Total monetised costs	<i>Not available at this point in time.</i>	n/a	n/a
Non-monetised costs		Low	Medium
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Some water service providers may improve transparency of their expenditure, revenues, and debt liabilities for each of the three waters. Clear and transparent information also supports evidenced-based decision-making. For councils that retain water service delivery in-house there will also be improved transparency and accountability on internal borrowing.	Low /Medium	Medium
Regulators	Improved transparency on water services financials and cash flow. Ensuring water revenues are spent on water services will support the Commission in its wider role as the economic regulator.	Medium	Medium
Others (e.g. wider Government, consumers etc.)	Improved transparency on where water revenues are spent, increased stakeholders' ability to hold water service providers accountable.	Medium	Medium

Total monetised benefits	Not available at this point in time.	n/a	n/a
Non-monetised benefits		<i>Medium</i>	<i>Medium</i>

Proposal Three: Introduction of enduring economic regulation

165. Three options that are led by MBIE are explored below:

- Option One – existing transitional provisions and information disclosure remain (counterfactual)
- Option Two – a targeted approach to economic regulation, with the ability to group water service providers (MBIE’s preferred option)
- Option Three – a comprehensive approach to economic regulation introduced for each water services provider.

Option One – Limited economic regulation and transitional provisions remain (counterfactual)

166. Under this option, as outlined in Bill 2, there would be requirements for councils to prepare Water Service Delivery Plans by mid-2025.

167. Water Service Delivery Plans must contain certain information, such as the current state of the water services and network, details of capital and operational expenditure required, financial projections, asset management approach, and risks impacting on delivery of water services.

168. Additional information disclosure can be required from some water service providers after a designation process which includes Ministerial decisions. Information on water services will continue to be collected by other agencies including:

- **Taumata Arowai**, the water services regulator, currently collects data for the purpose of ensuring water services providers are meeting drinking water standards, and limited information on stormwater and wastewater services.
- **Regional councils**, under the LGA have some information-gathering powers. For example, councils are required to provide water-specific performance measures to the Department.
- **Water New Zealand**, a water industry body, uses data from territorial authorities for their National Performance Review dashboard.

Option Two – A targeted approach to economic regulation, with the ability to group water service providers (MBIE’s preferred option)

169. This option would establish a targeted economic regulation regime for water service providers.

Providers could be grouped and moved through the regime in stages

170. There would be an ability for the Commission to group providers together, with different groups being subject to different regulatory measures. This approach would allow the Commission to introduce more stringent requirements for some providers, and a lighter regulatory burden for other providers.

171. For example, the Commission could group providers into three main groups as follows:

- large providers may require further oversight and/or bespoke requirements such as fast-tracking to price-quality regulation where overcharging is a problem
- medium sized CCOs that are responsive to regulatory incentives may only require information disclosure to drive performance

- small rural councils may have a more limited ability to respond but face significant challenges with improving efficiencies.

Information disclosure would form the basis for the regime and apply to all providers

172. An information disclosure regime, led by the Commission, would form the basis of the regime and would apply to all providers.
173. Under information disclosure, the Commission sets requirements on when certain information must be collected and then disclosed to the Commission. The Commission must then analyse and report on the information disclosed publicly (for example, on the Commission's website). Information may include benchmarking suppliers' performance against each other, including relative financial performance.
174. Under this option, the Commission would be able to require water service providers to prepare periodic forward-looking information. This includes, but is not limited to, forecast capital investment, operating costs, revenue, tariffs/charges, and financing plans required to meet drinking water and environmental standards. Information would be standardised so that it is comparable across water service providers, to the extent possible. Provision would be made for the Commission to require these plans to be independently verified.
175. The Commission could also require the disclosure of backwards-looking information that show the actual capital investment, operating costs, revenue, tariffs/charges and financing undertaken over a period. The Commission would review this information to determine which water service providers are improving asset and financial management, making efficient investments in infrastructure, implementing pricing practices that reflect costs, and providing a quality of service that reflects community expectations.

Revenue thresholds would be set using a risk-based approach

176. Under this option the Commission would be able to set minimum and/or maximum revenue thresholds as a screening mechanism to help ensure that water service providers invest sufficiently in infrastructure. The Commission would set revenue thresholds using a risk-based approach, by prioritising water service providers with the greatest levels of under-recovery and under-spend, before focussing attention on service improvements for other water service providers.

Infrastructure quality standards (quality-only) and performance requirements could be applied to water service providers where it was for the long-term benefit of consumers

177. In addition to its other regulatory powers, after mid-2026 the Commission would be able to recommend to the Minister of Commerce and Consumer Affairs that a water service provider should become subject to quality-only regulation (infrastructure quality standards) and performance requirements. This could only occur if the Commission considered it was for the long-term benefit of water services consumers. This would be done through a 'designation process', whereby economic regulation is applied or removed from one or more provider or service.
178. The purpose of infrastructure quality standards is to incentivise improvements in infrastructure performance by setting outcomes that regulated entities need to meet, which can then drive investment in assets or operational expenditure to meet these outcomes. Infrastructure quality standards are also a feature of overseas regimes. This

quality regulation is different from, but would be complementary to, Taumata Arowai's role regulating drinking water safety and environmental performance⁴.

179. Performance regulation would require providers to perform certain actions to improve network service quality. For example, it could include making certain investments, or to seeking approval from the Commission on investment programmes.

The Commission could also apply price-quality regulation

180. Under this option, after mid-2026, the Commission would be able to recommend to the Minister of Commerce and Consumer Affairs that a water service provider should become subject to price-quality regulation (be "designated") if:
- minimum or maximum revenue threshold is unjustifiably breached, or
 - through other monitoring activities, the Commission considers price-quality regulation is in the long-term benefit of water services consumers (consistent with the Part 4 of the Commerce Act purpose statement).
181. Price-quality regulation sets a specific 'price-quality path' for designated water service providers.
182. If the Minister of Commerce and Consumer Affairs approves the Commission's recommendation to designate a water service provider the Commission would be able to use comparative efficiency benchmarks to set maximum and/or minimum revenues. This would include the level of capital and operating expenditure required to deliver water services, while meeting environmental and drinking water standards.
183. The Commission would also be able to smooth prices and revenue within and between regulatory periods. Revenue smoothing is a key tool used under Part 4 (and the Telecommunications Act) to enable the Commission to manage the impact of price shocks on consumers where step changes in investment are needed, which will be relevant in the water services context due to historic underinvestment.
184. If a water service provider is designated as subject to price-quality regulation, the Commission should be able to set price-quality regulations without input methodologies (explained below) from mid-2026.

Full input methodologies would be set at a later date

185. Under this option, information disclosure and (if required) price-quality regulation would initially be able to be set without input methodologies during a transitional period.
186. Input methodologies are the rules and processes that the Commission sets upfront to help provide certainty about how specific services will be regulated under Part 4 of the Commerce Act. The input methodologies apply to key components of the regulatory regime such as how assets are valued, costs are allocated, and the cost of capital which influences how risk is shared between businesses and consumers, which also determines how businesses are compensated for their return on investments.
187. After commencement, the Commission would be able to set information disclosure requirements, including revenue thresholds, without input methodologies. The Commission would be required to set these requirements six months after

⁴ For example, it is possible that drinking water quality is sufficient, but the network quality is not sufficient because of the number of leaks, water pressure or other issues. Similar metrics may be used across regulatory regimes to monitor performance while minimising regulatory costs, which can be managed with information sharing arrangements to avoid regulatory duplication.

commencement (likely mid-2026). However, there would be the ability to defer this deadline with agreement from the Minister of Commerce and Consumer Affairs.

188. The Commission would then be required to set input methodologies for both information disclosure and price-quality regulation (if a water service provider has been designated) within ten years after commencement (likely mid-2035) but with the ability to defer this deadline with agreement from the Minister of Commerce and Consumer Affairs.

Cost recovery of the economic regulation regime

189. Under this option there would be the creation of a power enabling the cost of the economic regulation regime to be recovered from levies on water service providers. This is discussed further in the attached Cost Recovery Impact Statement (See **Annex Two**)

Option Three – A Comprehensive approach to economic regulation introduced for each water service organisation Option Three – A Comprehensive approach to economic regulation introduced for each water services provider

190. Under Option Three, a comprehensive economic regulation regime would be introduced for all water services providers. This would be led by the Commission and would initially comprise of information disclosure, with price-quality regulation (underpinned by input methodologies) introduced for all water service providers from 2030.

Information disclosure

191. As in Option Two, information disclosure requirements would initially be set without input methodologies, with the Commission expected to set the requirements for information disclosure within six months of commencement.
192. Each water service provider would face the same disclosure requirements and work to set input methodologies would commence concurrently.

Progressing to price-quality regulation once input methodologies set

193. Under this option, price-quality regulation would be introduced for all providers from 2030, following input methodologies being set in 2030.
194. A comprehensive regulatory approach applied equally to the whole sector would ensure consistent requirements for each provider and provide the strongest oversight of the three options outlined. However, the lack of discretion to tailor requirements across such a variety of providers means there is a substantial risk of undue regulatory burden on some providers.

Input methodologies to be set by 2030

195. In order to expedite the introduction of the enduring regime, the Commission would have approximately three years to develop input methodologies (rather than the ten years under Option Two).
196. Over the long term, there are strong benefits in input methodologies being determined due to the certainty it provides regulated suppliers and investors. Prioritising this certainty will be of particular value if all providers are to be subject to full price-quality regulation.
197. However, the process for setting input methodologies (including the associated merits appeals process) can be resource intensive and time-consuming. A constrained

timeframe runs the risk of diverting resources from the initial task of gathering quality information on the sector and setting regulatory requirements that drive performance improvements in the short to medium term.

How do the options compare to the status quo?

	Option One – Limited economic regulation and transitional provisions remain (counterfactual)	Option Two – A targeted approach to economic regulation, with the ability to group water service providers (MBIE's preferred approach)	Option Three - A comprehensive approach to economic regulation introduced for each water services provider
Improves incentives, efficiency and accountability for sustainable performance	0 Regulation continues to focus on drinking water quality and compliance with environmental standards. Limited economic regulation means there is some independent assurance to consumers that water services are being efficiently managed and that costs to consumers are reasonable, however there is no ability to impose further oversight if necessary.	+	+
Improved evidence-base to inform delivery decisions	0 Evidence on economic performance and efficiency will improve with the introduction of transitional information disclosure but will not have the same level of evidence base without revenue thresholds.	+	+
Supports a financially sustainable approach for council delivery of water services	0 Transitional provisions will improve information and therefore efficiency which will support governors and managers of water services to make decisions that improve economic performance over time. Improved information and oversight will also improve debt financing, but this could be improved with the ability to escalate oversight.	+	+
Enables improved quality, resilience, and residential growth	0 Limited ability for the regime to adapt and respond to changes in the sector.	+	+

	Option One – Limited economic regulation and transitional provisions remain (counterfactual)	Option Two – A targeted approach to economic regulation, with the ability to group water service providers (MBIE's preferred approach)	Option Three - A comprehensive approach to economic regulation introduced for each water services provider
		services to improve quality, resilience, and to support residential growth.	services to improve quality, resilience, and to support residential growth.
Provides a practical path for implementation	0 No further implementation required compared to what is already set out in Bill 2. Transitional provisions provide short-term certainty.	<p style="text-align: center;">+</p> <p>The resource that this option would require, (both in terms of time, cost and resource required) will depend on each individual council and the state of their water services.</p> <p>There will be compliance costs for councils to complete the necessary financial disclosure and planning as part of the economic regulation regime. Compliance and administrative costs will however be tailored to characteristics of councils.</p> <p>This option is also quicker because it is more targeted and does not involve setting price-quality paths from the outset, which are time and resource sensitive.</p>	<p style="text-align: center;">-</p> <p>A full application of economic regulation to all provides certainty to providers. However, some councils will struggle with the increased regulatory oversight and increased compliance costs for councils to complete the necessary financial disclosure and planning as part of the economic regulation regime.</p> <p>Central government will also need to work towards having all the necessary information to support the design and implementation of economic regulation at the start. Setting price-quality paths for all water services providers would take several years. This could impact on how efficient the first iteration of the regulatory scheme is.</p>
Overall assessment	0	+	+

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

198. MBIE recommends Option Two, a targeted approach to economic regulation, with the ability to group water service providers.
199. This option ensures efficiency through:
 - ensuring the provision of water services at the lowest possible long-run cost (subject to improved water quality and infrastructure standards)
 - incentivising the recovery of costs and efficient investment in water infrastructure
 - ensuring prices/charges reflect the costs of delivering water services.
200. This option also ensures that consumers understand the relative performance of their suppliers and can hold suppliers to account through their consumer engagement activities, and that the provision of water services that meet community expectations and consumer preferences.
201. This option is also quicker than Option Three. This is because it is more targeted and does not involve setting price-quality paths from the outset, which are time and resource sensitive.
202. Unlike Option Three (a comprehensive approach to economic regulation for each water service provider), this option provides for a targeted approach and the grouping of providers.
203. As part of the development of Proposal One and the preferred option, MBIE has engaged with the TAG, the Department, and the Commission.
204. Overall, the TAG, the Commission and the Department supported a flexible and targeted approach which is reflected in Option Two.

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups	Initial implementation costs incurred to set up systems and processes to collect the data required by the economic and consumer protection regulator. Ongoing compliance costs incurred from information collection and disclosure, and potentially other forms of regulation.	Medium	Medium
Regulators	Initial and ongoing establishment, implementation, and enforcement costs.	Medium	Medium
Others (e.g. wider Government, consumers, etc.)	Small financial cost to households of implementing this regime expected, as the entities pass on cost of levy.	Medium – refer to CRIS attached.	Medium
Total monetised costs	Refer to CRIS (Annex 2)	Medium – refer to CRIS attached.	Medium
Non-monetised costs		Low	Medium
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Improved information to make investment decisions. Greater public confidence.	High	Medium
Regulators	n/a	n/a	n/a
Others (e.g. wider Government, consumers, etc.)	Efficient infrastructure investment decisions by the entities. Receive reliable and high-quality water services. Increased information about water asset management decisions	High	Medium
Total monetised benefits	Refer to CRIS (Annex 2)	High	Medium
Non-monetised benefits		High	

Proposal four: Assistance and intervention

205. Three options are explored below:

- **Option One:** Current framework for Ministerial powers of assistance and intervention framework (in Part 10 of the LGA) plus additional mechanisms provided for in the Bill 2 in relation to council Water Services Delivery Plans (counterfactual)
- **Option Two:** Strengthened assistance and intervention framework for the water services provided directly by councils (building on counterfactual arrangements)
- **Option Three:** Strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on counterfactual arrangements) (the Department's preferred approach)

206. Under all options, wider regulatory powers that sit with system regulators remain:

- Taumata Arowai has compliance and enforcement powers that apply to drinking water suppliers under the Water Services Act 2021 which would apply to any form of local government drinking water supplier.
- Regional councils have roles in relation to environmental regulation, and powers to deal with non-compliance relating to wastewater and stormwater networks.
- The design of the future economic regime will include regulatory powers for the Commission to deal with non-compliance by regulated water service providers.

Option One – Current framework for Ministerial powers of assistance and intervention framework (in Part 10 of the LGA) plus additional mechanisms provided for in the Bill 2 in relation to council Water Services Delivery Plans (counterfactual)

207. Under this option, the “Powers of the Minister of Local Government to act in relation to local authorities” in Part 10 of the LGA would continue to apply, unaltered. This provides the Minister with a ‘menu of options’ that may be considered when problems arise in local authorities – including appointing a Crown Review Team, Crown Observer, Crown Manager, or replacing a council with a Commission.

208. Under this option, the provisions in Bill 2 would also apply with regard to bespoke Ministerial powers of assistance and intervention in relation to Water Services Delivery Plans. These powers include the ability to appoint:

- a Crown facilitator to help councils that may have difficulties preparing Water Services Delivery Plans and developing financially sustainable arrangements
- a person/team to prepare a Plan on a council's behalf, if it fails to submit one by the statutory deadline, or a Plan does not meet statutory requirements.

209. If a council fails to proceed with and implement the proposals in its Water Services Delivery Plan, this is a ‘problem’ under Part 10 of the LGA. This means that the Minister can consider using any of the Ministerial powers to act to address the problem that are currently in Part 10.

Option Two – Strengthened assistance and intervention framework for the water services provided directly by councils (building on counterfactual arrangements)

210. This option would only apply to the direct council delivery of water services, and not to CCOs or any new forms of water organisation.

211. Under this option, additional, enduring assistance and intervention powers/tools would be provided, for a LWDW context. This will build on Part 10 of the LGA, and the changes made under Bill 2 – but components of those changes would be expanded and made permanent. The main difference between this option and option 3 is that the legislative framework would continue to apply only to local authorities, so in a water services context it would only be relevant to councils that continue to deliver water services in-house. This is in line with the current legislative approach, whereby Ministerial powers to act apply only to local authorities, not any organisations they own or have an interest in.
212. Under this option the range of Ministerial bodies that can be appointed would be expanded. The new bodies would be permanent options, which are specific to the water services context, and could be appointed to identify and implement solutions to a range of issues relating to council water service delivery.
213. There would be two new bodies: ‘Crown facilitator – water services’ and ‘Water Services Commissioners’.
214. The Crown facilitator would expand on the role that is provided for in Bill 2, but the nature and scope of the role would be more wide-ranging. It could be used, for example, to help resolve situations where councils are failing to implement their Water Services Delivery Plans and need help to address the reasons for this. It would be positioned as an ‘assistance’ tool – though it could have some powers to direct councils, depending on the circumstances.
215. This role could involve, for example:
- negotiating/brokering solutions across multiple councils
 - helping individual councils to find, enter into and/or manage effective long-term contracting arrangements or some other form of joint arrangement (voluntarily) – if they have difficulties doing this themselves.
216. The option of Water Services Commissioners would be a more significant ‘intervention’ tool. It could be used in situations where a Crown facilitator or other options are not sufficient, and substantial powers to make and implement decisions are needed. It would be particularly relevant where a solution needs to be found across multiple councils, and it is not feasible or appropriate to replace elected members of several councils with Commissioners under the current Part 10 provisions.
217. This option could involve, for example, a team of experts being deployed to work with councils across a region (or parts thereof) to ensure joint arrangements/solutions are implemented.

Option Three - Strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on counterfactual arrangements) (the Department’s preferred approach)

218. Under this option, the approach described in Option Two would also apply – i.e. the addition of two new Ministerial bodies to the current menu of options: Crown facilitator - water services and Water Services Commissioners.
219. However, the scope of the assistance and intervention framework would be expanded so that it can apply to all forms of council-owned water service delivery providers – not just councils. This expands the scope of the framework substantially by allowing for existing and proposed new powers to be used to address problems that arise in any form of council-owned water service provider.

220. Under this option, the framework would also be amended so that:

- the definition of a 'problem' would be more flexible and made relevant to all council-owned water service providers, and appropriate for a wide range of potential situations that may arise in future (without being tailored to specific scenarios)
- the roles of the current Ministerial bodies would also be modified, as appropriate to the water services context.

221. In practice, these changes could mean, for example, that Ministerial bodies could be appointed to deal with situations that involve different kinds of council-owned water service delivery providers (not just those directly delivered by councils), including vehicles with multiple council owners, and board arrangements.

How do the options compare to the status quo?

	Option One – Current framework for Ministerial powers of assistance and intervention framework (in Part 10 of the LGA) plus additional mechanisms provided for in Bill 2 in relation to council Water Services Delivery Plans (counterfactual)	Option Two – Strengthened assistance and intervention framework for the water services provided directly by councils (building on counterfactual arrangements)	Option Three – Strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on preliminary arrangements) (the Department's preferred approach)
Improves incentives, efficiency and accountability for sustainable performance	<p style="text-align: center;">0</p> <p>There are no changes to the framework as set out in the LGA, which has limitations and does not apply to all forms of council-owned water service providers. Further, the provisions in Bill 2 are a useful addition, but only apply in relation to water services delivery plans.</p>	<p style="text-align: center;">+</p> <p>Additions and refinements to the assistance and intervention framework to make it more applicable to the issues and problems associated with council delivery of water services.</p> <p>Its improved applicability to council-delivered water services will strengthen incentives on councils to increase their focus on, and to improve their direct management of, water services to avoid Crown intervention in their delivery of water services.</p> <p>Because it will only apply to water services directly delivered by councils, it is unlikely to result in incentives to achieve the financial sustainability of water services not directly delivered by councils and will be limited in its effectiveness.</p> <p>Ministerial powers will also be more reflective of the issues and problems within the water services context, and there will be greater oversight of plans.</p>	<p style="text-align: center;">++</p> <p>Because the strengthened assistance and intervention framework will apply to all forms of council-owned water services delivery arrangements (not just direct council delivery), it will result in incentives across all council-owned delivery models to improve financial performance to avoid the risk of Crown intervention.</p> <p>Because the strengthened powers apply to all types of council-owned water services providers, they do not affect council choice in favour of one type of water service delivery arrangement over another.</p>
Improved evidence base to inform delivery decisions	<p style="text-align: center;">0</p> <p>Current settings mean that there is a relatively high bar for performance intervention, which does not enable speed or agility.</p>	<p style="text-align: center;">+</p> <p>Additions and refinements to the assistance and intervention framework, particularly the focus on information gathering, aims to make the framework more extensive and appropriate in relation to council water service provision and more easily used by the Minister. However, these changes won't apply to other models.</p>	<p style="text-align: center;">++</p> <p>Additions and refinements to the assistance and intervention framework, particularly the focus on information gathering, aims to make it more extensive and appropriate in relation to all council-owned water services (not just services directly provided by councils). This will improve the evidence base to inform the delivery of all council approaches to water service delivery.</p>

	Option One – Current framework for Ministerial powers of assistance and intervention framework (in Part 10 of the LGA) plus additional mechanisms provided for in Bill 2 in relation to council Water Services Delivery Plans (counterfactual)	Option Two – Strengthened assistance and intervention framework for the water services provided directly by councils (building on counterfactual arrangements)	Option Three – Strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on preliminary arrangements) (the Department’s preferred approach)
Provides a financially sustainable approach for local council delivery of water services	<p>0</p> <p>Persistence of large variations across councils on their financial performance, high bar for performance intervention.</p>	<p>+</p> <p>Additions and refinements to the assistance and intervention framework can help to incentivise councils to make changes to their water services delivery arrangements, to be financially sustainable and meet statutory requirements – by providing a clear set of powers that may be used if this does not happen. However, these powers would only be limited to council only.</p>	<p>++</p> <p>Additions and refinements to the assistance and intervention framework can help to incentivise councils to make changes to their water services delivery arrangements, to be financially sustainable and meet statutory requirements – by providing a clear set of powers that may be used across all types of council-owned water organisations if this does not happen.</p>
Enables improved quality, resilience, and residential growth	<p>-</p> <p>Unlikely to be suitable to address the kinds of issues and challenges faced by water service providers.</p>	<p>+</p> <p>The refinements to the assistance and intervention framework ensure that it is flexible and relevant to council water service provision (direct delivery model), and appropriate for some situations that may arise in future. As such, Ministerial powers will be more reflective of the issues and problems within the water services context, and there will be greater oversight of plans. This option also brings in strong backstop powers and incentives around behaviours. Further, there is an increased focus on ‘assistance’ with the ability to help resolve situations where councils are failing to implement their Water Services Delivery Plans. However, the limited application could mean that many potential problems cannot be addressed in the longer run as councils adjust delivery approaches.</p>	<p>++</p> <p>The refinements to the assistance and intervention framework ensure that it is flexible and relevant to water service provision, and appropriate for a wide range of potential situations that may arise in future. As such, Ministerial powers will be more reflective of the issues and problems within the water services context, and there will be greater oversight of plans. This option also brings in strong backstop powers and incentives around behaviours. Further, there is an increased focus on ‘assistance’ with the ability to help resolve situations where councils are failing to implement their Water Services Delivery Plans.</p>
Provides a practical path for implementation	<p>0</p> <p>No additional implementation is needed. The powers and tools are also only available in relation to a local authority, not to any entity that the local authority may control or have an interest in. This</p>	<p>+</p> <p>Provides for an assistance and intervention framework to support councils as they implement the wider proposal that is focused on assistance. However, as refinements will not be applicable to wider water organisations, this could lead to an</p>	<p>+</p> <p>Provides for an assistance and intervention framework to support councils as they implement the wider proposal that is focused on assistance. However, the ability for the framework to service water organisations other than councils may affect</p>

	Option One – Current framework for Ministerial powers of assistance and intervention framework (in Part 10 of the LGA) plus additional mechanisms provided for in Bill 2 in relation to council Water Services Delivery Plans (counterfactual)	Option Two – Strengthened assistance and intervention framework for the water services provided directly by councils (building on counterfactual arrangements)	Option Three – Strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on preliminary arrangements) (the Department’s preferred approach)
	means they do not apply to CCOs or any new form of water organisation.	inconsistent approach across all water services providers and mean that many potential problems cannot be addressed.	accountability arrangements between the boards of those organisations and their council owners. However, the ability for the framework to service water organisations other than councils may affect accountability arrangements between the boards of those organisations and their council owners. That said, Ministerial intervention powers are intended as a ‘last resort’, and responsibility for dealing with problems with council-owned organisations would lie with those owners in the first instance.
Overall assessment	-	+	++

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

- 222. The Department recommends Option Three, a strengthened assistance and intervention framework in relation to water services, applicable to all forms of local government water service providers (building on preliminary arrangements).
- 223. This option provides for a comprehensive, transparent and easy to understand statutory framework that is suitable for all forms of local government water service delivery vehicles and arrangements.
- 224. It provides flexibility to address a wide range of problems, and agility to ensure matters can be dealt with quickly.
- 225. It also clearly defines the roles and responsibilities across the system – including an approach that:
 - provides appropriate statutory powers for the Minister and the Department in the new water service delivery context
 - aligns with, supports, and does not duplicate the roles of regulators to deal with non-compliance with their regulatory systems (Taumata Arowai, Commerce Commission, regional councils)
 - clarifies and reinforces expectations that councils will fulfil their responsibilities – including as owners of water service providers, and
 - fits in and aligns with the broader framework for Ministerial powers to act in relation to local authorities (as appropriate/relevant).
- 226. As part of the development of Proposal Three (the preferred option), the Department has consulted with MBIE.

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups	Expenses associated with Ministerially appointed bodies (if used) would be recovered from councils or other water service providers.	Low	Low Unknown how many councils/providers will need support as part of the assistance and intervention framework.

Regulators	Cost to the Department associated with monitoring the implementation of Water Services Delivery Plans, and related activities.	Low	Medium
	Costs to the Department for providing advice on the potential use of powers of assistance and intervention relating to water services.	Low	Low It is unknown how many situations will arise that require advice.
Others (e.g., wider govt, consumers, etc.)	n/a	n/a	n/a
Total monetised costs	<i>Not available at this point in time</i>	n/a	n/a
Non-monetised costs		<i>Low</i>	<i>Low</i>
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Supports water service providers to be in a position to meet service delivery and regulatory requirements, and to address any issues/challenges they may face.	Medium	Low
Regulators	Provides a range of fit-for-purpose mechanisms/tools for ensuring regulatory requirements and the objectives of LWDW are being met – which complement and supplement the regulatory powers that sit with system regulators.	Medium	Medium
Others (e.g., wider govt, consumers, etc.)	Water services are a lifeline utility, where the consequences of failure are very significant – meaning providers cannot ‘fail’. This framework provides an appropriate range of mechanisms/tools to help ensure problems are identified and addressed swiftly.	Medium	Medium
Total monetised benefits	<i>Not available at this point in time</i>	n/a	n/a
Non-monetised benefits		<i>Medium</i>	<i>Medium</i>

Section 3: Delivering an option

227. As noted in section one, the four proposals assessed in this section of the RIS are interconnected and complete each other. Therefore, **implementation and monitoring aspects are discussed as a whole package**, with specifics mentioned where relevant.

How will the new arrangements be implemented?

228. As noted previously, LWDW was a National Party manifesto commitment as part of the 2023 General Election. The arrangements that are discussed in the RIS are signalled in the 100-point Economic Plan and were announced by the Government in February 2024.

229. As a result, councils are aware of the upcoming changes and the Department has been ensuring councils are aware of the specific changes and implications as part of Bill 2.

Implementation of new water organisations

230. Under Proposal One, “optionality of water services providers”, Option Two (the preferred) legislative change would be introduced to enable a range of water service providers, with clear minimum requirements for all vehicles. Councils would have flexibility to determine to optimal delivery method for their water services.

231. Guidance is being provided to councils on the range of vehicles that are likely to be made available. This builds on the information made available post the enactment of Bill 2 to inform the Water Service Delivery Plans and will help councils to assess which vehicles are most appropriate for their circumstances.

232. Should councils choose to shift delivery models, they will be entirely responsible for meeting the requirements under the amended legislation.

Implementation of minimum ringfencing arrangements

233. The Commission would be responsible for enforcing the ringfencing requirements for water service providers. To support the implementation, they could use a range of tools, if and when they deem necessary, such as:

- setting clear rules and guidance
- conducting regular audits
- ensuring transparency
- engaging stakeholders
- establishing feedback mechanisms
- providing training
- pushing for legal adjustments when needed.

Implementation of economic regulations

234. Under Option Two (the preferred option), the Commission would be required to set the requirements for the initial phase of information disclosure by approximately six months after commencement (likely early-2026).

235. However, there would be the ability to defer this deadline with agreement from the Minister of Commerce and Consumer Affairs.

236. The Commission would set revenue thresholds using a risk-based approach, by prioritising WSPs with the greatest levels of under-recovery and under-spend, before focussing attention on service improvements for other WSPs.
237. The Commission would then be required to set input methodologies for both information disclosure and price-quality regulation (if a WSP has been designated) within ten years after commencement (likely mid-2035) but with the ability to defer this deadline with agreement from the Minister of Commerce and Consumer Affairs.
238. At a local level, the resource that this option would require (both in terms of time, cost and resource required), will depend on each individual council and the state of their water services. This would provide for a targeted approach and the grouping of providers to ensure that interventions are targeted on improving the performance of the least financially sustainable water services.

Implementation of assistance and intervention framework

239. Powers under the new assistance and intervention framework and who might be appointed, would need to be considered on a case-by-case basis. This would take into account specific issues and circumstances, with the Department keeping a watching brief on how the wider policy proposals played out (e.g. the implementation of Water Service Delivery Plans). If and when necessary, the Department would provide advice to the Minister of Local Government if any issues seem to be emerging.
240. More information on the changing role of the Department is discussed below.

How will the new arrangements be monitored, evaluated, and reviewed?

241. This section describes the overall approach to monitoring, evaluation and review for water services, including how the Department, MBIE, and the Commission would monitor and review regulatory changes to ensure that they are performing well.
242. Overall, monitoring and evaluation for the four proposals would be focused on the degree to which each option is achieving its objectives, with a focus on whether local council delivery of water services are financially sustainable and meet minimum regulated quality standards for communities. Monitoring would also need to consider how the Treaty of Waitangi obligations are applied, wherever the Crown has a role, function or responsibility in relation to the monitoring functions listed below.
243. This section discusses both the overall provisions that will be put in place given the interconnectedness of the proposals, as well as specific points for each proposal.

There would be a mandatory review of the water services system in five years' time

244. Consideration has been given to mechanisms for maintaining some 'pressure on the system', incentivising councils to restructure their water services arrangements, and considering the long-term effectiveness of the service delivery and associated regulatory systems.
245. As such, there are provisions for a mandatory 'system-wide review of water services' to be undertaken five years after the Bill is enacted. The timeframe and matters to be covered in the review would be specified in the legislation.
246. This could involve provisions that required the Minister of Local Government to commission a review of the overall operation and effectiveness of the:
 - water services legislation

- structure of the local government water services delivery system – including considering the extent to which council Water Services Delivery Plans have been implemented, and the arrangements that have been put in place, and
 - implementation of new regulatory requirements.
247. This review would include an industry-wide ‘stocktake’ and potentially some form of ‘self-assessment’ by councils in relation to the outcomes sought by LWDW. The reviewer could be given certain powers in the legislation (to obtain information, for example), and required to do a report, with recommendations for the Minister to consider.
248. There are also a number of wider monitoring and evaluation provisions in place for water services across New Zealand, many of which have been used to inform the evidence for the first RIS. For example:
- audit reports, including water performance audits and LTP audits, from the Office of the Auditor-General
 - regular reporting on drinking water quality and network environmental performance measures to Taumata Arowai, and
 - Water New Zealand’s National Performance Review.
249. **Annex Three** provides a summary of the regulatory roles across the water services system.

Monitoring of performance by the Commerce Commission

250. As noted earlier, LWDW provides that the regulation of water services will be brought into Part 4 of the Commerce Act 1986 and regulated by the Commission.
251. The Commission will have a range of responsibilities for water service providers, including:
- overseeing information disclosures, and assessing the information provided
 - providing recommendations to the Minister of Commerce and Consumer Affairs about price-quality regulation
 - set quality performance metrics after consultation with stakeholders, and
 - monitoring compliance with legislated ringfencing requirements, including the ability to act on any breaches.
252. A key feature of the preferred proposals is information disclosure, which is an enhanced regime for recordkeeping and transparency to enable the Commission to monitor regulated suppliers’ performance, including relative performance and changes in performance over time.
253. The Commission may, as part of a summary and analysis, include an analysis of how effective the information disclosure requirements imposed on the goods or services are in promoting competitive outcomes. The anticipated impacts of the new arrangements will be identified by this means.
254. Further, the monitoring of ringfencing requirements would help align ringfencing requirements with economic regulation, and requirements will be refined through the development of input methodologies to standardise the treatment of shared costs, assets and services.

255. Therefore, overall success will be evident when councils begin to develop and provide necessary information, thereby fostering a more transparent regime and offering data and evidence to support future decision making. This would support the Commission and councils to develop the capability and capacity needed for the proposed enduring economic regulation. The foundational information disclosure under the first phase would help to inform the development of the enduring information disclosure requirements. The extent to which councils comply with this first phase would influence its ongoing policy development.
256. An effort will be made as part of the legislative design process to ensure that there is not a duplication between functions across entities.
257. MBIE would also monitor the economic regulation regime as part of its general regulatory stewardship responsibilities.

Ongoing monitoring by the Department of Internal Affairs

258. The assistance and intervention framework would have implications for the Department's role, and how they support Ministers beyond the enactment of Bill 2. In particular, the Department's role would include greater monitoring and oversight of the implementation of these provisions.
259. The Department would need to have an ongoing role in:
- monitoring the implementation of Water Services Delivery Plans (after they have been accepted in accordance with Bill 2) to understand council performance (e.g. if they are focussed on water services delivery and on track to achieving financial sustainability)
 - providing advice and recommendations on the potential use of powers of assistance and intervention relating to water services.
260. To do these roles effectively, it is proposed that the Secretary for Local Government be granted with powers to support and enable the Department to undertake these roles.
261. The Department would need the ability to require information from councils and other water services providers relating to the implementation of Water Services Delivery Plans, and situations where 'problems' may arise in the water services context. This would supplement evidence and analysis from the Commission and other regulators.
262. Although the Department already provides the Minister with support in respect to Part 10 of the LGA (and more broadly in relation to the local government system and framework), specific monitoring and advice relating to water services would likely require additional levels of expertise and resourcing.

Policy objective around financial sustainability

263. As mentioned in section 1, it is anticipated that the package of proposals presented, along with the preliminary arrangements, will result in strong incentives on councils and new organisation. These will include options for councils to achieve the policy objective which is that they will deliver water services that are **financially sustainable** and meet minimum regulated quality standards for communities.
264. However, councils will have different starting points in terms of the state of their infrastructure assets and ability to raise revenue and reduce expenditure. They are likely to have different capabilities and capacities to respond to incentives and to utilise new organisation options to reorganise their delivery of water services, and different rating bases to fund required investments and costs. There is a risk that some council

water service providers would struggle to adequately respond to economic incentives and achieve sufficient efficiencies in their delivery of water services without further central government support.

265. The package of proposals includes improved oversight, monitoring and intervention tools (outlined in proposal four) to provide additional support to some councils if necessary and to better understand the extent to which a provider is at risk of financial failure. It would also be important to monitor and evaluate the effectiveness of the proposals in supporting councils to make necessary adjustments to their delivery and management of water services including establishment of multi council entities and shared service arrangements to realise scale efficiencies.
266. The package of regulatory interventions (both the proposals outlined in this RIS, alongside the preliminary arrangements) is able to:
- increase transparency around all relevant costs (including legacy and future water infrastructure costs)
 - identify whether prices and charges are sufficient to cover all costs
 - provide incentives and options for councils to reorganise and better manage delivery of water services
 - provide for improved ability to borrow (where possible in terms of debt limits and ability to service interest costs to better fund services (including addressing deferred maintenance), and
 - achieve efficiency gains through better management and making it easier to reorganise to achieve scale efficiencies including multi council approaches and shared services.
267. This as whole, is expected to result in improved financial performance for the majority of councils over time. However, as noted in section 1, there may be some councils that are unable to achieve financial sustainability and fail to respond or cannot achieve improvements. For these councils, there will be step in powers as outlined in proposal four. In these cases, the system oversight and monitoring arrangements described above, as well as the assistance and intervention framework described as part of proposal four, would be important to determine whether changes are having the intended effects and potentially whether further intervention may be necessary.

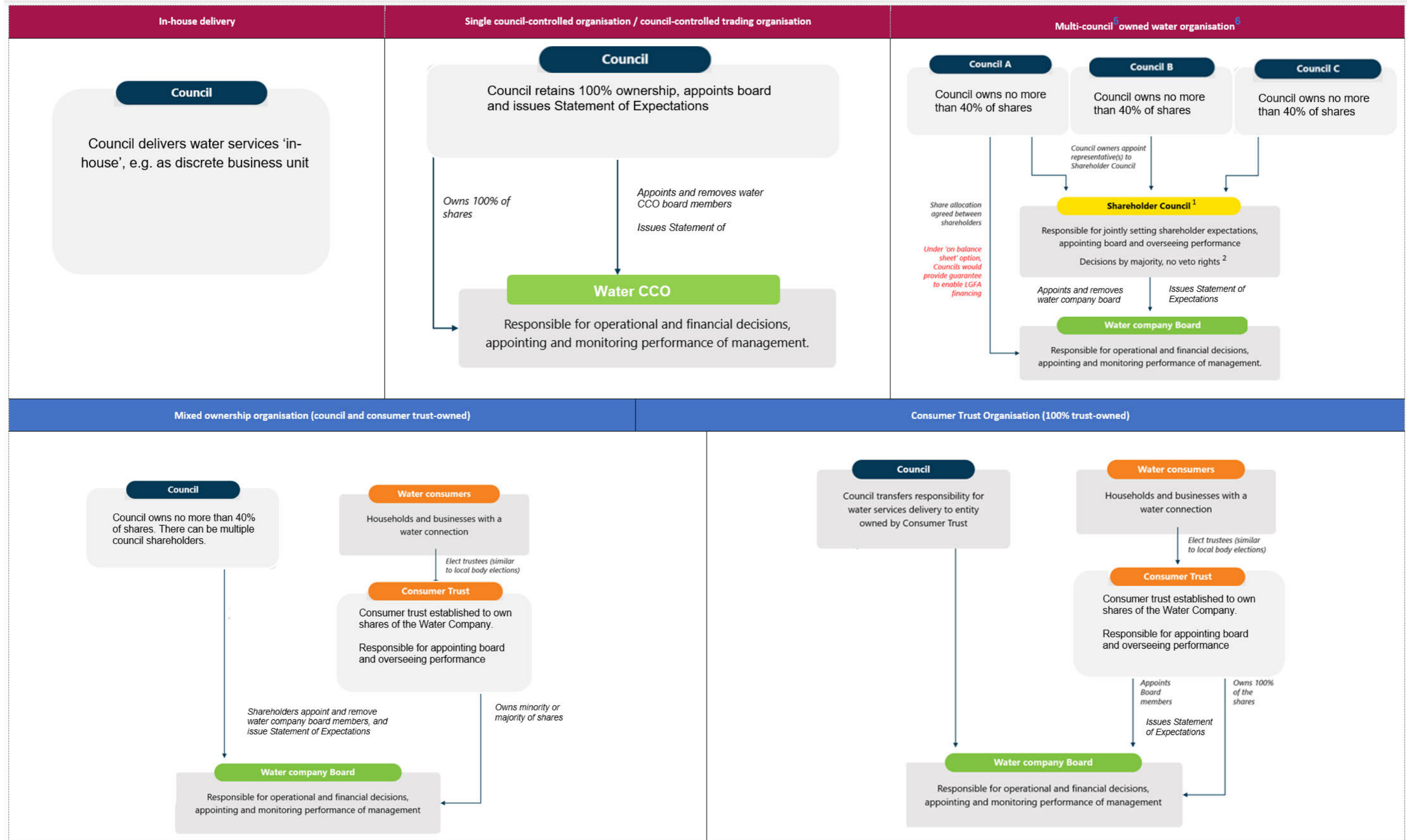
An assessment of overarching regulatory oversight is occurring

268. As part of the overarching regime, the regulatory environment would need adjustments to ensure effective implementation. The regulatory environment for water services delivery already includes water quality and environmental regulation and will include economic regulation in the future.
269. To be able to improve how our water services are regulated and meet the objectives of LWDW, there is a need to look at how the overall regulatory system operates, including:
- who the regulators are and what activities they regulate
 - how roles and responsibilities are arranged across agencies
 - what the current regulatory problems are
 - how the system can be changed to achieve desired outcomes.

270. There is a need to understand how related regulatory systems influence the functioning and outcomes of the water services system, particularly the resource management system. Officials will continue to work closely with the Ministry for the Environment to enhance the water services regulatory system as part of the longer-term resource management reforms, including the review of the National Policy Statement on Freshwater Management and the development of national direction for infrastructure, the development of any national environmental standards, and other directly related policy work.
271. The Department is working to identify the key weaknesses in the current system and define the objectives for the new regulatory system, taking into account overall principles for good regulatory design as well as principles specific to water services regulation.
272. This work will also highlight what changes are needed to ensure a more cohesive regulatory environment across the regulators.
273. As the economic regulation regime develops, the Government will likely have choices about how the different regulators contribute to the overall regulatory system and have the opportunity to ensure that the regulators' roles, and the allocation of regulatory functions and powers reinforces the intended objectives of LWDW. This will be done once the economic regulation regime is operational.

Annex One: Summary of water service providers

Proposed water services delivery models



¹ Note there will be no requirement for a shareholder council in legislation. This would be expected to be included in a company constitution.

² Note there will be no restrictions on majority voting/veto rights in legislation. This would be expected to be included in a company constitution.

Features	In-house delivery	Single Council CCO/CCTO	Multi-council owned water organisation	Consumer Trust water organisation (100% trust-owned)	Mixed ownership (council and consumer trust-owned) organisation
<i>Minimum requirements</i>					
Subject to economic, environmental and water quality regulations	✓	✓	✓	✓	✓
Subject to bespoke planning and accountability framework	✓	✓	✓	✓	✓
Must be financially sustainable, including ringfencing of water services	✓	✓	✓	✓	✓
Subject to restrictions against privatisation	✓	✓	✓	<ul style="list-style-type: none"> Also subject to additional restrictions to ensure that consumer trust cannot transfer ownership interests, and the trust represents consumer interests 	<ul style="list-style-type: none"> Also subject to additional restrictions to ensure that consumer trust cannot transfer ownership interests, and the trust represents consumer interests
Must act consistently with statutory objectives	✓	✓	✓	✓	✓
<i>Additional requirements</i>					
Ownership and management arrangements <ul style="list-style-type: none"> Shareholding is limited only to councils and consumer trusts Limits on ownership rights including restrictions on transferability of shares, who can own shares, and limits on the rights that can attach to shares Water assets can transfer from parent council(s) to water organisation. The parent council(s) may own the assets and the water organisation manages them, or ownership may transfer to the water organisation itself. 		✓	✓	✓	✓
Boards must be independent and professional <ul style="list-style-type: none"> Current council staff and elected members cannot be appointed to the boards Board members must be appointed on the basis of competency 		✓	✓	✓	✓
Must be companies		✓	✓	✓	✓
Activities limited to water services, and directly related activities		✓	✓	✓	✓
Balance sheet treatment	<ul style="list-style-type: none"> On balance sheet 	<ul style="list-style-type: none"> On balance sheet 	<ul style="list-style-type: none"> Can be on balance sheet or off balance sheet (subject to testing with rating agencies) 	<ul style="list-style-type: none"> Off balance sheet 	<ul style="list-style-type: none"> Off balance sheet
Governing legislation	<ul style="list-style-type: none"> Local Government Act 2002 	<ul style="list-style-type: none"> Local Government Act 2002 Companies Act 1993 	<ul style="list-style-type: none"> Local Government Act 2002 Companies Act 1993 	<ul style="list-style-type: none"> Local Government Act 2002 Companies Act 1993 Requirements in legislation or general law relating to trusts 	<ul style="list-style-type: none"> Local Government Act 2002 Companies Act 1993 Requirements in legislation or general law relating to trusts

Annex Two: Stage 1 Cost Recovery Impact Statement

Implementing Local Water Done Well – Cost Recovery to Enable Economic Regulation

Status quo

Local Water Done Well

Local Water Done Well (LWDW) provides that the regulation of water services will be brought into Part 4 of the Commerce Act 1986 and regulated by the Commission.

Water services providers are natural monopolies⁵ and there are issues that are apparent in the water services system, including:

- significant long-term underinvestment in water infrastructure, including councils not investing in and planning for growth and urban development
- pricing practices that do not reflect costs, including undercharging and service quality that does not reflect community expectations
- poor asset and financial management
- drinking water and wastewater services that do not meet regulatory standards and requirements – in some cases, resulting in poor quality drinking water, unreliable supplies, and poor environmental outcomes
- ineffective transparency and accountability mechanisms.

Electricity distribution and transmission services, gas pipeline services and certain airports are also natural monopolies that are regulated under Part 4 of the Commerce Act 1986. Part 4 provides for the regulation of the price and quality of goods or services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition. The purpose of Part 4 is to promote the long-term benefit of consumers in such markets by promoting outcomes that are consistent with outcomes produced in competitive markets.

Water services providers are to be regulated under Part 4 to promote competitive outcomes, including efficiency, quality, transparency and accountability, with a particular focus on ensuring there is adequate oversight of the risks relating to WSPs: underinvestment, undercharging, and revenue insufficiency.

Current funding arrangements

Local government currently charges for water services through a range of mechanisms, including rates on property owners.

In relation to the Commission's economic regulation functions under Part 4 of the Commerce Act 1986, the Commission receives annual or multi-year non-departmental appropriations from the Crown which are fully recovered by levies on regulated entities under that Part. Section 53ZE of the Commerce Act 1986 provides for the marking of regulations requiring the responsible Minister to charge a levy to any provider, or class of providers, of regulated goods and services. The amount of the levy is based on the Commission's estimate of costs

⁵ A natural monopoly is a type of monopoly in an industry or sector with high barriers to entry and start-up costs that prevent any rivals from competing. As such, a natural monopoly has only one efficient player. This company may be the only provider of a product or service in an industry or geographic location.

for the class of regulated goods and services as specified in the appropriation(s) in the Main Estimates of Appropriations for the levy year. At year end, a reconciliation process is conducted based on the Commission's actual costs, capped by the appropriation(s).

Taumata Arowai is currently Crown funded, however the intent is that it be levy funded and the Water Services Act 2021 provides for regulations prescribing a levy for the purpose of recovering any or all of the costs that relate to the performance or exercise of its functions, powers, and duties. The establishment of Taumata Arowai was Crown funded.

The delay in developing regulations for the levy funding of its ongoing operations has been due the interdependency of levy funding options with proposals for service delivery reform. It is now expected the levy will come into effect from July 2025.

Legislative change proposed

The legislation for LWDW sits across three bills. The first bill repealed aspects of the previous regime. Cabinet has approved the policy for Bill 2 which will be enacted in mid-2024. This will include requirements for councils to prepare Water Services Delivery Plans (due August 2025) and foundational information disclosure requirements that can apply to some providers after a designation process. This current Bill will contain additional provisions to fully establish the economic regulation regime under Part 4 of the Commerce Act 1986.

Legislative amendments will need to be made to bring water services into this regime. These amendments can be made through Bill 3 described above.

Policy Rationale: Why a charge? And what type is most appropriate?

Based on the policy positions detailed in the RIS, there will be costs associated with the economic regulation regime (proposal 4). For example, the Commission incurs costs in analysing the data disclosed by regulated suppliers and undertaking compliance activities.

There are a number of options that can be considered for funding costs associated with developing and implementing economic regulation of water services, including fees and levies, as well as direct Crown funding.

The Commerce Act 1986 provides for regulations to allow suppliers of regulated goods or services to be charged levies. Where there are direct beneficiaries of the regulators and where the regulator's activities are necessary to mitigate risks presented by the conduct of an individual or group of individuals, cost recovery mechanisms may be justified⁶.

Assessment of who should pay – Crown or a form of charge?

In general, fees or levies are considered to be an appropriate funding tool where it is possible:

- to **identify specific individuals or groups that directly benefit** from a given Government activity or service
- to **efficiently charge or levy individuals or groups** that benefit from a given Government activity or service⁷

⁶ Controller and Auditor-General (2021). Setting and administering fees and levies for cost recovery: Good practice guide [Setting and administering fees and levies for cost recovery: Good practice guide \(oag.parliament.nz\)](https://oag.parliament.nz/setting-and-administering-fees-and-levies-for-cost-recovery-good-practice-guide)

⁷ The Treasury. (2017). Guidelines for Setting Charges in the Public Sector. www.treasury.govt.nz/sites/default/files/2017-04/settingcharges-apr17.pdf

Fees and levies are often suited to situations where there are significant private benefits to individuals or groups rather than society at large (i.e., public benefits delivered from a public good). If there are identifiable public benefits, then funding from general taxation is likely to be a more appropriate funding tool. If there is a mix of public and private benefits then a mix of fees/levies and funding from general taxation is likely to be appropriate, weighted according to the balance of private and public benefits.

The table below uses these guidelines to develop three principles to guide who should pay for the increased costs of regulating water services.

Principles	Assessment
Proportionally across public private benefits	<p>There is a predominantly private benefit to consumers served by the water service providers. While there are general public benefits driving the entities to invest efficiently in water infrastructure, like other utilities, the economic regulation of water services is specifically designed to directly benefit the long-term interests of consumers of the services (private benefits).</p> <p>The private and public benefits of the regulator cannot readily be translated into quantitative benefit. Accordingly, percentages or proportions for the level of private and public benefit cannot be established. Instead, allocations and assessment of benefit are constrained to a more generalised assessment as described above.</p>
Ability to identify specific individuals or groups that directly benefit from a given Government activity or service	It is possible to identify parties that directly benefit from economic regulation, including being able to identify/exclude those who do not benefit.
Ability to efficiently charge or levy individuals or groups that benefit from a given Government activity or service	Like other services, there is the ability to identify (as above) and then cost effectively charge the ultimate beneficiaries of the economic regulation regime.

The ability to use levies to at least partly fund the economic regulation regime is recommended because of the proportionality of benefits, and the ability to identify parties that directly benefit from economic regulation, and effectively charge them. This also means that there is an ability to avoid charging the 15% of people who will not be served by the water service providers – i.e. those who are rurally located.

In summary, because it is possible to identify parties that directly benefit from economic regulation, most of the costs of implementing economic regulation are typically levied on the supplier of regulated services. These costs are then passed through to consumers in the prices they pay for regulated services. The ability to identify and cost effectively charge the ultimate beneficiaries of the economic regulation regime suggests that most of the costs of the regime should be met from charges on consumers.

This in line with other economic regulation regimes, where the costs of implementing economic regulation are typically levied on the supplier of regulated services, and then passed through to consumers in the prices they pay for regulated services. For water services, water services providers are likely to pass these costs on to users of a water services network, and will have discretion over how this is done.

This is seen as justified as consumers served by each provider are the ultimate beneficiaries of the economic regulation. Consumers will receive a bill from the regulated provider for the cost of the services, and it is efficient that this is charged at the same time, using the same billing systems and requiring a single payment from the end user (as opposed to multiple).

It is noted that some consumers will have different ability to pay. For the purposes of this RIS, levy funding on the entities will ensure the economic regulation regime will continue to be funded by the levies charged on the entities despite any one consumer's ability to pay.

At the time of writing, it is unclear how many water services providers there will be. Some councils will work together to form CCOs) that will provide water services across territorial authorities. Other councils will continue to provide water services in isolation. Estimates of the cost of economic regulation to the Commission vary depending on the number of regulated parties and are considered in the following section.

Assessment of levy or fee

The main difference between a fee and a levy is that it is generally compulsory to pay a levy, and it is usually charged to a specific group (rather than relating to specific services provided to an individual).

A levy is seen as more appropriate because the costs of the regime will need to be levied on regulated suppliers as a proxy for the diverse range of consumers that ultimately benefit.

High level cost recovery model (the level of the proposed fee and its cost components)

Costs associated with the regime

The table below sets out indicative costs of the economic regulation regime for water services. Although costs vary significantly depending on the number of water services providers to be regulated and the regulatory tools used by the Commission.

These estimates are informed by the Commission's costs regulating other utilities. To account for the uncertainty regarding the number of regulated providers, the table below outlines a range of scenarios from 20 – 50 providers.

Regulation	Information disclosure (no Input Methodologies ⁸)	Financial ringfence rules	Quality and performance tools	Threshold setting	Price-quality (no input methodologies and no merits appeals)
Set by	Early 2026 onwards	From 2026 onwards	June 2026 onwards	From circa June 2028 onwards	From circa June 2028 onwards
20 – 30 providers	9(2)(g)(i)				
30 – 40 providers					
40 – 50 providers					

Each tool has been priced separately but total costs should be summed across the rows as more tools are implemented, i.e., only the marginal costs of quality, thresholds and price-quality are shown.

The costs do not include a role for the Commission in consumer protection.

The legislation is likely to require the setting of input methodologies 10 years after commencement unless brought forward or deferred by the Minister of Commerce and Consumer Affairs. Based on recent implementation of the fibre regime, 9(2)(g)(i) . To set price-quality without input methodologies, the Commission will still need to develop regulatory rules and guidelines, 9(2)(g)(i) .

As noted in the supporting RIS, a second set of proposals will be provided to Cabinet in the next month, and a further RIS will be provided which assesses those proposals. It is expected that this will include proposals relating to consumer protection.

If additional consumer protection tools are proposed, these will incur costs not considered in this analysis, and as such, these will be set out in later analysis that supports this advice.

⁸ Input methodologies are the rules and processes that the Commerce Commission sets upfront to help provide certainty about how the Commission will regulate specific services under Part 4 of the Commerce Act 1986.

How would a levy funded model work?

As outlined above, it is considered that levies are appropriate (rather than fees or other charges) as this is consistent with the approach taken to economic regulation of other sectors under the Commerce Act 1986 regime.

There are two broad levy design options that should be considered:

- a regulator led levy regime similar to that used by the Electricity Authority under the Electricity Industry Act 2010
- a Minister-led levy regime similar to that administered by MBIE under Part 4 of the Commerce Act 1986 regulation regime.

These two options are described in the table below.

	Option One: Regulator led levy regime	Option Two: Minister led levy regime
Description		
What is the process used to set the levy?	Regulator publicly consults on its work programme and required funding.	Ministry consults on funding required (on behalf of the Minister) in close consultation with the regulator.
Who sets the final amount of the levy?	The Minister sets the total amount of levy funding by determining the regulator's appropriation(s) in the Main Estimates of Appropriations for the levy year. The levy rates applying to industry participants are calculated in accordance with the allocation mechanism specified in the levy regulations and are published in the Gazette.	The Minister sets the total amount of levy funding by determining the regulator's appropriation(s) in the Main Estimates of Appropriations for the levy year. The levy rates applying to industry participants are calculated in accordance with the allocation mechanism specified in the levy regulations. Levy payers are notified of their levy liability.
Who collects the levy?	Regulator.	Ministry, on behalf of the Minister.

These two options are assessed in the table below.

	Option One: Regulator led levy regime	Option Two: Minister led levy regime
Assessment		
Benefits	Can be seen as more transparent and predictable. Requiring the regulator to consult on its work programme and funding needs can promote	Can create a degree of separation between the regulator and regulated parties. This separation promotes the

	<p>efficiency in the regulator’s activities. Consultation provides a useful accountability mechanism to consumers, regulated suppliers and other stakeholders.</p>	<p>regulator’s independence to act in the public interest.</p> <p>Is consistent with the approach taken by the Commission in regulating other utilities. So would be efficient to use this model as there are established relationships between the Commission, the monitoring agency MBIE, and the Minister of Commerce and Consumer Affairs.</p>
Costs	<p>There can be a perceived risk of the regulator consulting regulated parties on its funding requirements, even if the final decision rests with the Minister.</p> <p>Would be inconsistent with other economic regulation regimes so new processes would need to be established.</p>	<p>The regulator may not give the same consideration to better or more cost-effective ways to carry out its functions.</p> <p>There is risk of inconsistent approaches to setting the levy as governments change.</p>

Consultation

Due to the legislative timeframes, there has been no consultation with stakeholders during the policy design process. However, officials have been able to rely on:

- evidence and insights collected through the public consultation of the previous policy programme (including select committee processes), and
- the government’s newly established Technical Advisory Group which has provided policy design input into the proposals included in this RIS (their specific feedback is not included in the RIS).

As part of previous consultation:

- Most submitters agreed the costs of implementing the economic regulation regime should be funded by levies on regulated suppliers, although several submitters were of the view the costs of establishing and implementing the regime should be funded by central government.
- Most submitters were of the view this should be regulator-led, with some submitters making the point that the levy process needs to be transparent and predictable.
- The Commission preferred a Minister-led levy model, as that is consistent with their approach to other regulated entities.

Further consultation on the proposed cost recovery model will occur as the relevant legislation is considered through the select committee process. Consultation on the regulations for setting the levy will be undertaken before the levy is set.

Conclusion

Consistent with the funding approach used in other economic regulated entities, it is proposed that a levy-based model is used.

On balance, while regulator led levy regime has benefits and is workable, MBIE prefers a Minister-led levy model. The Minister-led model is consistent with the approach taken by the Commission (the preferred economic and consumer protection regulator) in regulating other utilities. Therefore, it would be efficient to use this model as there are established relationships between the Commission, the monitoring agency MBIE, and the Minister of Commerce and Consumer Affairs.

Annex Three: Regulatory roles across the water services system

We need to understand who the regulators are in the system and what activities they regulate

Regulatory agency

		Taumata Arowai	Regional Councils	Territorial Authorities	Commerce Commission (new)
Activity that is regulated	Drinking water <ul style="list-style-type: none"> Storage Water treatment Water network 	<ul style="list-style-type: none"> Regulate source water quality for storage Regulate water quality and safety Taumata Arowai have a role in monitoring the environmental performance of regional councils 	<ul style="list-style-type: none"> Regulate water quantity through consents for water takes 	<ul style="list-style-type: none"> Regulate growth and development through land use consents Require land use consents for drinking water storage facilities and treatment plants 	<ul style="list-style-type: none"> The Commission will be the long-term economic regulator of drinking water, wastewater and stormwater (excluding those owned or operated by a transport corridor manager). This will promote better transparency and oversight of these water services Will regulate information disclosure – including financial information, asset values, prices, contracts, transactions with related parties, performance measures, plans and forecasts, capacity, efficiency improvements, asset management plans, quality performance measures and statistics) Will regulate quality – will have ability to set infrastructure quality standards and performance requirements for water services. Quality standards could include minimising leaks, water pressure or response times to complaints Will have the ability to require providers to perform certain actions to improve quality standards such as: adopt a particular approach to risk management and asset management Will regulate price-quality Compliance – pecuniary penalties for non-compliance of the above regulatory tools, such as failure to provide information by due date, breaching quality standards, performance requirements, or maximum and minimum revenues. Backstop / reserve powers – could provide a recommendation to the Minister of Local Government to appoint a manager or observer in the event of persistent non-compliance with the above regulatory tools Stormwater should be able to be excluded from quality and price-quality regulation
	Wastewater <ul style="list-style-type: none"> Storage Water treatment Water network 	<ul style="list-style-type: none"> Are developing environmental performance standards for wastewater treatment plants, and monitoring and reporting of wastewater overflows Standards will cover: <ul style="list-style-type: none"> discharge to water (freshwater and ocean) overflows – proposing a national level framework for risk-based monitoring and reporting of overflows disposal of biosolids discharge of effluent to land Taumata Arowai have a role in monitoring the environmental performance of regional councils 	<ul style="list-style-type: none"> Regulate water quality and quantity through discharge consents for discharges to land, water and the coast 	<ul style="list-style-type: none"> Regulate growth and development through land use consents Require land use consents for wastewater storage facilities and treatment plants 	
	Stormwater <ul style="list-style-type: none"> Storage Water treatment Water network 	<ul style="list-style-type: none"> Not yet clear if environmental performance standards will be developed for stormwater 	<ul style="list-style-type: none"> Regulate water quality and quantity through discharge consents for discharges to land, water and the coast 	<ul style="list-style-type: none"> Regulate growth and development through land use consents 	

Notes:

- Small drinking water suppliers may be exempt from regulation – being considered
- Stormwater regulation applies mainly to piped systems

IN-CONFIDENCE