

November 2021

Three Waters

Where to from here?

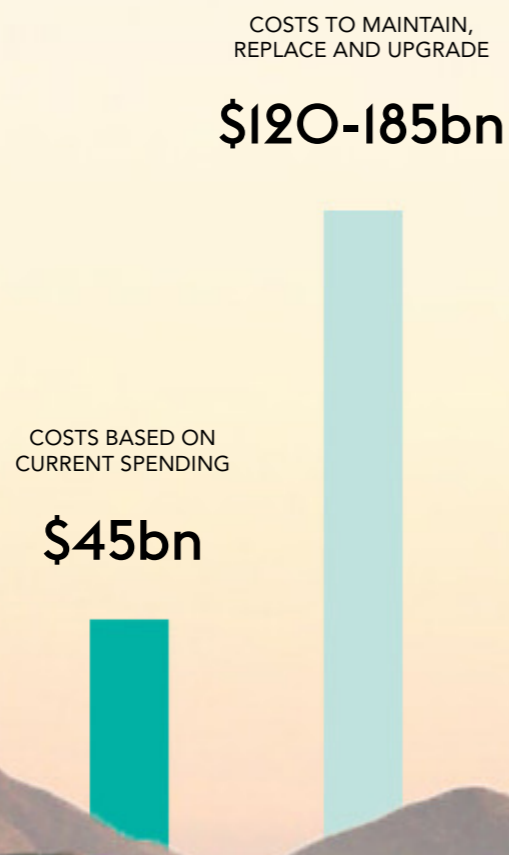
Since our last update in June 2021, under the leadership of Hon Nanaia Mahuta, the Government has continued to progress its proposed full-scale regulatory and structural reform of water service delivery across Aotearoa New Zealand.

In June 2021, Cabinet decisions were released on the approach that will be taken to the reforms. These decisions will result in the establishment of new water services entities, which will take over the responsibilities for water service delivery from local authorities. The latest Cabinet decision released in October 2021, following a two-month consultation period with councils, makes it clear that the Government will proceed with the reforms using a legislated 'all in' approach, removing the ability for councils to 'opt out' of the reforms.

In this report, we summarise the decisions made on the reforms to date, and the further policy work required.

Russell
McLeagh





Where things stand

The Three Waters Reform Programme proposes structural and regulatory reform rarely seen on this scale in Aotearoa New Zealand. The Government’s view is that there are urgent problems we face and economic and consumer benefits to be unlocked by tackling them. It also believes that reform provides an opportunity to achieve lasting benefits for the local government sector, our communities, and the environment.

The Government considers that the scale of investment required in three waters infrastructure to ensure acceptable water quality is unbearable for local authorities (many of whom have historically underinvested). The latest estimates indicate that investment in the order of \$120 billion to \$185 billion is required over the next 30-40 years to replace and refurbish existing water infrastructure, provide for future population growth, and upgrade three waters assets to meet drinking water and environmental standards. Current aggregate council spend is around \$1.5 billion annually (or \$45 billion over the next 30 years).

The Reform Programme is estimated to deliver a \$14-\$23 billion new increase in GDP over 30 years and will support the creation of 5,900 to 9,300 additional new jobs countrywide between 2022 and 2051.¹

¹ Press Release: Reports prove case for urgent water infrastructure reform, Hon Nanaia Mahuta, 2 June 2021: Reports prove case for urgent water infrastructure reform | Beehive.govt.nz.



Four new publicly-owned water entities

Local Government Minister Nanaia Mahuta has recently confirmed that the Government will push on to create four publicly-owned water entities and that the Three Waters reforms will be mandatory for all councils. This is a significant shift from the prior position of encouraging councils to participate in the reform on a voluntary basis with appropriate financial incentives, but perhaps inevitable in the face of mounting local authority opposition pushing against the Government's conviction that large scale reform was essential. The restructuring will see the management of the majority of New Zealand's stormwater, drinking water and wastewater assets moved out of the hands of 67 territorial authorities to four large water entities, to be operational by 1 July 2024.

The boundaries for the new water entities have been proposed based on scale and population size. The new entities will be run by boards with input from councils and mana whenua, and with expertise in water infrastructure.

The reform process includes the following parts:

Reform process	Status
Establishment of a new water regulator (Taumata Arowai).	Complete.
A new drinking water and wastewater regulatory framework, to be administered by Taumata Arowai.	In progress - legislation passed, to be implemented by Taumata Arowai.
Economic regulation of the new water service entities.	In progress - public consultation on policy options commenced.
Legislation to establish the new water services entities (the Water Services Entities Bill).	Due to be introduced by the end of 2021.

What regions will the new water entities cover?

The proposed boundaries for the four publicly-owned water services entities are based on scale and population sizes, and cover:

Entity A: Auckland and Northland;

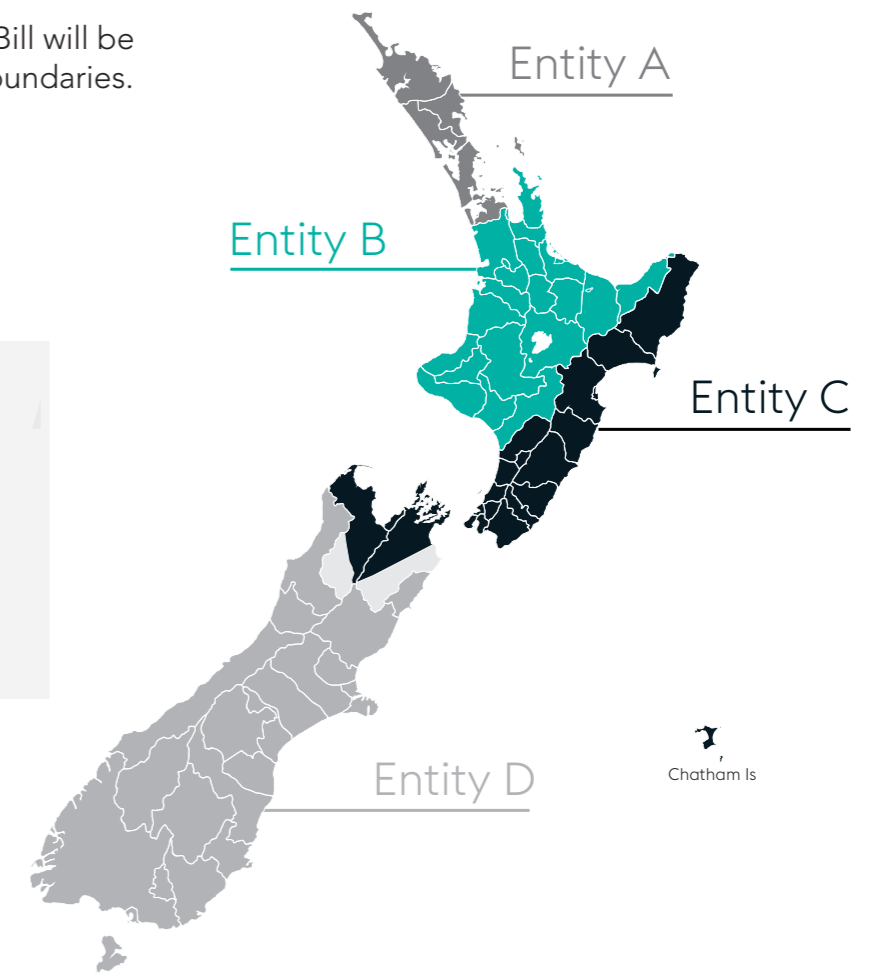
Entity B: Central North Island (including Taranaki);

Entity C: East Coast North Island, as well as the top of the South Island; and

Entity D: the remainder of the South Island.

The Water Services Entities Bill will be prepared based on these boundaries.

	connected population
Entity A	1,725,850
Entity B	799,610
Entity C	955,150
Entity D	864,350





Who will own the new water entities?

The new water entities will be publicly-owned. The constituent local authorities of each entity will be the owners of the entity, as provided for in legislation. However, there would be no financial recognition of ownership, or shareholding. Ownership rights are instead provided for in the oversight and governance arrangements of the entities.

Mana whenua would not be owners of the water entities but would have a joint oversight role with local authorities.

How will the new water entities be created?

The new water entities will be statutory entities, created by legislation. They will have:

- a statutory purpose to provide safe, reliable and efficient water services;
- a range of objectives that flow from this purpose (such as efficient and financially sustainable delivery of services and infrastructure, operating in accordance with best commercial and business practice, supporting and enabling housing and urban development); and
- powers, functions and responsibilities required to fulfil their statutory purpose and objectives, and undertaking the roles envisaged, including the powers and responsibilities relating to water service delivery that are currently held by local authorities under various pieces of legislation.

“ The Government will push on to create four publicly-owned water entities and the Three Waters reforms will be mandatory for all Councils. ”

What will governance involve?

The governance model will be unique, but will have similarities to the crown entity and council-controlled organisation statutory models, including:

- legislation will include specific objectives for the entities;
- central government will provide strategic policy direction through a Government Policy Statement, which the water entities will be required to “give effect to”;
- a Statement of Strategic and Performance expectations would be issued, which will inform a statement of intent against which the entities publicly and formally report back;
- requirements to compile and/or adhere to various strategic plans, including an Asset Management Plan, and Funding and Pricing Plan; and
- in the event of a serious performance issue with a water entity, the Crown will intervene.

The uniqueness of the proposed model is that local authorities and mana whenua will jointly exercise governance rights. Key features include:

- local authorities and mana whenua will jointly (50/50) appoint a Regional Representative Group (RRG);
- each RRG would consist of no more than 12 members and comprise equal numbers of representatives from local authorities and mana whenua that constitute the geographical area covered by the water services entity;
- the RRG will appoint an Independent Selection Panel (ISP), which appoints Board members; and
- the RRGs would consider the findings of an annual review of board performance undertaken by the ISP.

This general governance framework could be subject to further design refinement, as discussed below.

What measures protect against privatisation of the new water entities?

Continued public ownership of water services is a bottom line for the Government. Protection against privatisation is a key reason for the statutory entity/ no shareholder approach described. Other proposed measures protecting against privatisation include:

- No dividends: The new water entities would not be able to pay dividends but would have the operational and financial flexibility to reinvest any surplus to ensure the efficient delivery of water services.
- Restrictions on asset sales or transfers: Legislation will include mechanisms to place restrictions on the sale and/or transfer of material, strategic three water assets held by the new water entities, similar to the protections that are currently provided for in the Local Government Act 2002.
- Referendum: The proposal is to include a requirement for a referendum to be conducted before any privatisation proposal.

How will the new entities be funded?

A Crown liquidity facility will be available to water entities, which can be accessed if certain ‘trigger events’ occur, on similar terms to those available to the Local Government Funding Agency.

Balance sheet separation remains a bottom line for the Government. It is intended that the water services entity governance framework, when taken together with the broader measures to implement the reform, will provide the entity with the financial capacity (including through the ability to borrow) to meet the future investment needs (including any infrastructure deficit) of the region it serves, without:

- resulting in the debt of water services entities consolidating onto the balance sheets of local authorities; or
- requiring additional financial support from the Crown (beyond what the Crown has already agreed to provide).



How will Te Tiriti be recognised?

The Water Services Act, once in force, will require drinking water suppliers, and other participants in the sector, to give effect to Te Mana o Te Wai, in executing any relevant duties under the Act.

Recent Cabinet decisions provide the following mechanisms for addressing iwi/Māori rights and interests within the new three waters service delivery model:

- Statutory recognition of both the Te Tiriti and Te Mana o Te Wai in legislation:
 - The water services entities would be required to give effect to the principles of Te Tiriti o Waitangi, and to engage with Māori.
 - A reference to Te Mana o te Wai, which can be exercised at an iwi/hapū and whanau level, primarily through the Te Mana o te Wai statement.
- The creation of a ‘mana whenua group’ that would have the same rights and mechanisms as territorial authorities to influence the boards of the new water services entities.
- The board of each water services entity will be required to have Te Tiriti competencies and members with specific expertise in enabling the exercise of mātauranga Māori, tikanga Māori, kaitiakitanga, and te ao Māori with respect to the delivery of water services.

Will further design changes be made?

Work is underway as part of the Heads of Agreement between the Government and Local Government to consider refinements to the proposal within the Government’s “bottom lines” of good governance, partnership with mana whenua, public ownership, and balance sheet separation. A working group of local government, iwi and water industry experts will work through the enhancements to entity design and look at the governance and accountability arrangements of the entities, as well as provide an opportunity for public participation and consultation.

When will public consultation on the reforms occur?

Public consultation on these reforms will occur at a national level rather than local level. There will be several opportunities for public consultation over the coming years, including public submissions via the Select Committee process for the Water Services Entities Bill, and public participation with the working group.

Additionally, once set up the water entities will be required to directly consult with their customers, businesses and residents on their strategic direction, investment priorities, their prices and charges to a level that will likely exceed the current requirements on local government.

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Gaps to plug

How will the assets be transferred?

Water assets, liabilities and staff would be transferred from local councils to the new water services entities. The Government's "no worse off" package to support local government transition through the reforms, intends to cover the costs and financial impacts that local authorities are likely to incur because of the reform (that is, due to the transfer of water services assets, liabilities, revenue and staff to a new water services entity).

It has been recognised that further work will be required to identify which powers, functions, responsibilities, and assets would be transferred to, and held and exercised by the new water entities, which will be a technically and legally complex process.

How will water services be priced?

The Three Waters reforms are designed to deliver much higher quality water services at a much lower cost than would be achievable if water services continue to be provided by 67 separate local authorities. The Government has confirmed that there will not be significant short-term changes to the way in which water services are currently paid for. However, over time, prices and charges will change to achieve a balance between affordability, equity and efficiency.

While the Government will undertake further work to understand the impact of different pricing structures and changes in pricing on consumers, it has confirmed that it will not be mandating the use of variable/volumetric charging as part of the reform.

The economic regulation regime will have a strong focus on ensuring that customers pay no more than they need to for the services they receive, while ensuring that the new water services entities are financially sustainable and can access the finance required to address the infrastructure deficit.

What type of economic regulation and consumer protection mechanisms will apply?

Final decisions are yet to be made. The most recent indications are that the economic regulation regime would be introduced gradually over 2022 to 2027, and is likely to involve:

- information disclosure regulation imposed on entities from 1 July 2026 to allow consumers and other interested stakeholders to compare the relative performance of water services entities;
- commencement of price-quality regulation of entities from 1 July 2027 that caps the maximum allowable revenue of water services entities and imposes minimum quality standards;
- information disclosure; and
- the appointment of an independent and credible economic regulator (not the Commerce Commission) to administer the regime.

Consumer protection mechanisms that will be considered for the new water service entities include:

- a dispute resolution process;
- the establishment of a consumer advocacy council (or the extension of an existing body) to provide expert advocacy on behalf of consumers;
- options to protect consumers who are vulnerable due to their age, health, disability, or financial position;
- requirements for price transparency; and
- an ability for a regulator to mandate service quality codes.

A discussion paper on the proposed economic regulation and consumer protection regime for the water services entities has been released by MBIE. This consultation will be open for feedback until 20 December 2021.

What about stormwater?

A key decision is that the new water entities will deliver all three waters, but the transfer of responsibility for stormwater is complex. A stormwater technical group has been established to develop a transition plan, which will need to:

- develop proposals for which stormwater assets will be transferred to the new water entities (eg roads will be excluded);
- ensure the new entities and councils can
- continue to work together to effectively manage stormwater; and
- identify a timeframe for transferring the responsibility for managing stormwater.

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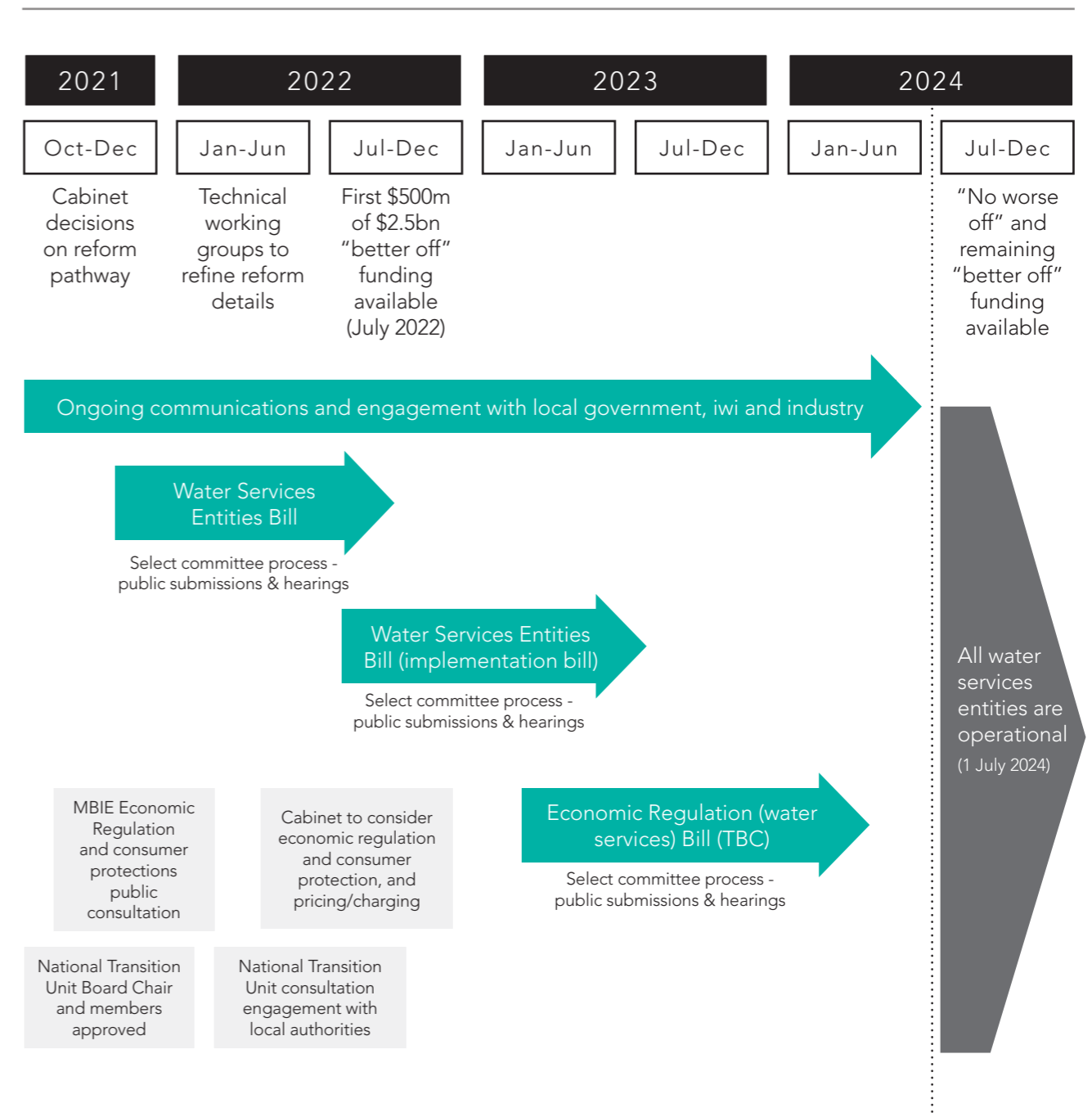
Where to from here?

Councils will continue delivering water services through the duration of the upcoming Long-Term Plan (until 1 July 2024).

The Government is pursuing the following ambitious reform timeframe.



Three waters reform timeline





Our team

Here to help

Steeped in years of experience advising on some of New Zealand's most transformative projects, Russell McVeagh has the sophisticated sector knowledge and insight to advise a broad range of stakeholders on one of this country's most daring reform programmes. Our experience includes advising Watercare, for more than two decades, in relation to its water and wastewater networks, and Fonterra on planning issues across the country, including on changes to water quality and in relation to Government policy reform.

We have the expertise to guide clients through the legal, regulatory and political challenges of New Zealand's changing water landscape. For more information, please contact a member of our Three Waters team.



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