COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

Submission on discussion paper on Economic Regulation and Consumer Protection for Three Waters Services in New Zealand

Submitted to: Ministry of Business, Innovation and Employment

16 December 2021

Commerce Commission submission on the discussion paper on Economic Regulation and Consumer Protection for Three Waters Services in New Zealand

Introduction

1. The Commerce Commission (the Commission) appreciates the opportunity to make a submission on the discussion paper on Economic Regulation and Consumer Protection for Three Waters Services in New Zealand.

2. The Commission is New Zealand's primary competition, fair trading, consumer credit, and economic regulatory agency. Our overarching objective is to make New Zealanders better off. We work to ensure markets work well, so that consumers and businesses can participate confidently. The Commission is submitting on this discussion paper based on:

    2.1 our experience as the current economic regulator in a number of sectors, including electricity, gas, airports, dairy, telecommunications, and fuel; and

    2.2 the discussion paper's preliminary conclusion that the Commerce Commission appears to be the most appropriate body to be the economic and consumer protection regulator for the three waters sector.

3. The Commission's submission does not take a position on the Government's objectives in respect of reform of three waters services. We do not consider that to be appropriate to our role. Rather, this submission focuses on what we think are the best ways to achieve the Government's objectives for three waters services, based on our experience with economic regulation and consumer protection in other sectors.

4. This submission sets out our preliminary views on the matters canvassed in the discussion paper, but we remain open-minded about (and happy to discuss) many of the issues. Regardless of the institutional arrangements that are ultimately decided on, the Commission would welcome the opportunity to continue to work with the Ministry of Business, Innovation and Employment (MBIE) and the Department of Internal Affairs (DIA) to support the successful design and implementation of any new economic regulation and consumer protection regime, given our role as an economic regulatory agency in other sectors.

5. Our submission is in two parts. The body of the submission sets out our substantive feedback on the discussion paper. Attachment 1 packages, draws from, and builds upon our substantive response in a format that responds to specific questions outlined in the discussion paper.

Summary of key feedback

6. Our key feedback on the discussion paper is summarised as follows:

6.1 We think some form of economic regulation and consumer protection regime will play a useful role in achieving the Government's intended objectives regarding three waters services.

6.2 The proposed structure and governance of the four Water Services Entities (WSEs) will have implications for the design and effectiveness of any economic regulation regime. In particular, we think the inability of WSEs to pay dividends may reduce the effectiveness of some economic regulation tools (such as a traditional regulated price path) at driving efficiency gains.

6.3 Our initial assessment is that information disclosure regulation, scrutiny of capital and operating expenditure, quality paths and/or performance requirements (see Paragraphs 36-39 below), the ability to set pricing principles to promote efficiency, and an ability to set a service quality code are the critical elements of the regime.

6.4 Given the proposed structure and governance of WSEs, and the uncertainties about the incentives they will face and what tools might best drive performance, we suggest consideration be given to providing the economic regulator with a comprehensive suite of regulatory tools. The tools in the suite would be more flexible in their use relative to under Part 4 of the Commerce Act 1986. This suite of tools would enable the economic regulator, subject to appropriate checks and balances, to deploy an initial effective regulatory approach and then over time make necessary changes as the system beds in and the incentives on WSEs become clearer. Additional tools could include an ability to set performance requirements as an extension of quality standards, and generally more flexibility regarding the form of economic regulation applied to regulated entities. We believe it is worth focusing on designing a regime that reflects the unique characteristics of WSEs, rather than simply adopting Part 4 of the Commerce Act with minimal modification.

6.5 We think designing the high-level architecture of the regime prior to considering matters of detail would be the best approach. However, we recognise the time constraints for the reform process, and so our submission also provides responses to questions asked in the discussion paper on matters of detail.

6.6 We caution against expectations that economic regulation can drive substantial efficiency gains in the short-to-medium term. We think this is challenging given the significant transition in the shift from our current governance and delivery arrangements to four WSEs, and our understanding that there is a lack of high-quality information available about the state of assets in the sector. Experience with other economic regulatory regimes

suggests that a long-term time horizon of five-to-ten years is required for an economic regulatory regime to mature and deliver substantial gains.

6.7 We agree with the assessment in the discussion paper of the options for institutional arrangements. We note that we already have a strong working relationship with Taumata Arowai. Our submission identifies a number of potential areas of overlap between the economic regulation and consumer protection regimes, and with the regime administered by Taumata Arowai under the Water Services Act 2021, and comments on how these might be addressed.

6.8 The economic regulation regime can and should be sufficiently flexible to take into account Te Tiriti o Waitangi and Te Mana o te Wai.

7. We elaborate on these points in the body of our submission.

Conclusion

8. Thank you for the opportunity to submit on the discussion paper.

9. Please contact Cam Vannisselroy, Principal Policy Analyst, Strategy, Policy and Performance in the first instance at cameron.vannisselroy@comcom.govt.nz in relation to questions regarding the Commission's submission.

Key feedback on the discussion paper

Economic regulation and consumer protection have a useful role in achieving Government's objectives regarding three waters services

10. The core focus of the discussion paper is on whether an economic regulation and/or consumer protection regime should be introduced in respect of three waters services, and, if so, what form this could take.

11. Economic regulation is a tool that drives improved performance and better outcomes for consumers from monopoly suppliers and in markets that are not working effectively in the absence of regulation. In particular, economic regulation can seek to:

    11.1 shine a light on good and poor entity performance;

    11.2 constrain the ability of regulated entities to extract excess profits from consumers;

    11.3 incentivise regulated entities to improve efficiency;

    11.4 improve the quality of service provided to consumers; and

    11.5 resolve information asymmetries and address principal-agent issues that may arise between the owners, board and/or management of an entity.

12. Similarly, sector-specific consumer protection regulation can promote informed decision-making by consumers, protect consumers from unfair practices, and work alongside economic regulation to drive better performance.

13. The following table sets out how we consider economic regulation and a sector-specific consumer protection regime may be able to support the Government to achieve its objectives in relation to three waters services.

Government objective regarding three waters services	**How economic regulation may assist meeting that objective**
Significantly improving safety and quality of drinking water services, and the environmental performance of wastewater and stormwater systems	While primarily matters for the regime administered by Taumata Arowai under the Water Services Act, to the extent that economic regulation results in improvements in infrastructure quality, it may have benefits for the safety and quality of drinking water services.
Ensuring all New Zealanders have equitable access to affordable three waters services	Economic regulation has the potential to promote efficiencies in the delivery of three waters services, which could result in more affordable services for consumers than in the absence of regulation. Depending on the contents of a service quality code, a consumer protection regime could also help drive equity by imposing

	protections for consumers in respect of matters such as billing and hardship.
Improving the coordination of resources and unlocking strategic opportunities to consider New Zealand's infrastructure needs at a larger scale	Economic regulation can drive better availability of information on the quality of infrastructure and future infrastructure needs.
The need to address the impacts of climate change and ensure the resilience of water services	Economic regulation can support greater resilience of infrastructure by enabling the regulator to scrutinise asset management plans, and setting quality standards or performance requirements that drive investment in more resilient assets.
Moving the supply of three waters services to a more financially sustainable footing, and addressing the affordability and capability challenges faced across the sector and particularly by some small suppliers and councils	A stable and predictable economic regulation regime, including the availability of high-quality information about WSEs' performance, can support the financeability of the sector and provide ratings agencies with confidence about the capacity and capability of WSEs to borrow funds.
Improving transparency and accountability for the delivery and costs of three waters services, including the ability to benchmark the performance of service suppliers	Information disclosure under an economic regulation regime can improve transparency and accountability and resolve information asymmetries between the proposed WSEs, their boards, regional representation groups, and their customers and communities.

The proposed structure and governance of the four Water Services Entities has implications for the design and effectiveness of an economic regulation regime

14. We consider that economic regulation and a consumer protection regime are needed to meet the objectives in respect of three waters services. However, the proposed structure, ownership and governance of the four WSEs, and the current state of water infrastructure in some parts of the country, have implications for the design and effectiveness of an economic regulation regime for water.

15. As we understand it, relevant current context for, and features of, the proposed regime include that:

    15.1 there is a lack of good quality information about the state of much water services infrastructure and the performance of current suppliers;

    15.2 there has been sustained underinvestment in water services infrastructure by some current suppliers;

15.3 the transition to WSEs is a significant change in the operating environment for the three waters sector and will take time to bed in;

15.4 new WSEs will not have an ability to pay dividends (entities could reinvest any surplus to ensure the efficient delivery of water services);

15.5 there will be complex multi-layered governance arrangements; and

15.6 there will be statutory recognition of the role of Te Tiriti o Waitangi and obligations for WSEs to give effect to Te Mana o te Wai.

16. Many of these factors suggest to us that the existing toolkit contained in Part 4 of the Commerce Act may be less effective when applied to three waters services than other industries that are currently subject to economic regulation. We think that, to get the best results, more creative interventions (and combinations of interventions) may be required to incentivise improvements in WSE performance.

17. We think that, given the factors described above, there may be limited benefit associated with applying a traditional price path to WSEs in the initial phases of WSE establishment. A traditional price may well be more effective when the regime has matured. We raise this point about limited benefit in the early stages because we believe there are likely to be difficulties associated with use of a price path to drive significant efficiency gains in the entities. It also appears there may be limited incentives for WSEs to overcharge. A price path also creates some risks in terms of the ability of regulated entities to obtain finance on appropriate terms. We elaborate on these views below and in Attachment 1.

18. Typically, economic regulation seeks to improve the performance of regulated entities through some combination of the use of:

18.1 information disclosure regulation to shine a light on both good and poor performance;

18.2 price or revenue controls to prevent monopoly returns from being earned, incentivise efficiencies, and assess investment plans;

18.3 quality, output, or other performance standards to ensure good-quality services are delivered to consumers and are not undermined by attempts to cut costs; and

18.4 financial penalties and other remedies for non-compliance.

19. While some of these measures will still be relevant to WSEs, we think the effectiveness of price or revenue controls and penalties for non-compliance is likely reduced by WSEs' inability to pay dividends and the lack of – in effect – equity holders in WSEs.

20. Under economic regulation, controls on maximum allowable revenue can incentivise profit-making entities to reduce costs to allow a greater return to be provided to

shareholders. Over time, these efficiencies are reflected in (all else being equal) lower maximum allowable revenues for entities, to ensure that efficiency gains are shared with consumers. However, on the face of it, an inability to pay dividends (as is the case with WSEs) substantially reduces the incentives that a regulated price path would provide WSEs to improve efficiency. This is because the benefits associated with efficiency gains cannot be shared with shareholders – either through dividends (because dividends cannot be paid), or through gains in the value of the entities (because they cannot be sold).

21. Similarly, the prospect of financial penalties and other remedies for non-compliance can provide a strong incentive for regulated parties to comply with economic regulation requirements, as the penalties paid lower the returns paid to shareholders. While the reputational impact associated with the imposition of financial penalties on a WSE will still likely be strong, financial penalties appear less likely to incentivise compliance, given WSEs' lack of ability to pay dividends. In other words, there is no shareholder return to be impacted by non-compliance, and, consequentially, no party with a direct incentive to ensure compliance by the entity. It is possible that the imposition of financial penalties could penalise consumers in the long run, as it could result in a need to raise prices, reduce the ability to lower prices, or otherwise compromise investment.

22. We believe that an appropriate regime can be developed to reflect these unique factors.

Focus on designing a regime that reflects the unique context of the Water Services Entities

23. Our initial view is that the elements of an economic regulation and consumer protection regime most likely to play a useful role in supporting the Government's objectives for three waters include:

    23.1 information disclosure regulation;

    23.2 scrutiny of capital and operating expenditure;

    23.3 quality paths and/or performance requirements (see Paragraphs 36-39 below);

    23.4 the ability to set pricing principles to promote efficiency; and

    23.5 an ability to set a service quality code.

24. The traditional role of a price path may be able to be replaced in part by additional emphasis on the tools already provided for in the toolkit contained in Part 4 of the Commerce Act, to the extent that these are carried over to a new economic regulation regime for water. For example, we expect that information disclosure regulation could potentially play a larger role for water than it has under other regimes. However, we also think that additional tools may be desirable.

25. The main value we think a traditional price path could provide for WSEs is the role for the regulator in scrutinising and ultimately approving capital and operating

expenditure. Scrutiny of this expenditure is likely to be particularly important, given the lack of efficiency incentives. However, such scrutiny can also be performed under an information disclosure framework. While this would not come with an 'approval' function as it does under a traditional price path, this could be accompanied by certain performance requirements relating to certification or cost-benefit analysis (see Paragraph 39 below).

26. Overall, the proposed structure of WSEs, the likely incentives they will face, the context of the water sector, and the overall uncertainty about how economic regulation will play out suggest that consideration should be given to whether an extended and more flexible range of tools than that provided for under Part 4 of the Commerce Act is desirable.

27. The degree of specificity contained in Part 4 of the Commerce Act appropriately reflects the desire at the time of the legislation's development to provide regulated entities with as much predictability and certainty as possible on the introduction of what was then a substantially new form of economic regulation.

28. However, the Commission recommends that MBIE and DIA assess whether the optimal balance between specificity and flexibility is different for water than it is for other matters regulated under Part 4. We consider that the optimal balance might differ, given the challenges described above in driving improvements in performance, and the fact that the operating incentives of proposed WSEs are not yet fully understood. More flexibility and a broader range of tools could provide a greater ability to respond to and influence the operating incentives of WSEs, once these are better understood. It could also enhance the durability of the regulatory regime.

29. Consequently, in designing any economic and consumer protection regime for three waters, we recommend that MBIE and DIA focus first and foremost on designing a regime that reflects the unique characteristics of the proposed WSEs, rather than simply carry over the existing legislative framework from Part 4 of the Commerce Act with minimal modification. We consider that new and separate legislation – rather than the Commerce Act or other existing legislation – will be desirable for any economic or consumer protection regime for three waters.

30. We also recommend that MBIE and DIA focus initially on the high-level design of the scheme before seeking Cabinet decisions on matters of detail. Having said this, we recognise the challenging reform timeline MBIE and DIA are working to. As such, we also address matters of detail below, and in Attachment 1.

Consideration could be given to some additional tools and flexibility

31. The discussion paper takes Part 4 of the Commerce Act as the starting point for the form and function of economic regulation of three waters. We consider that, to best enable success in this new area of regulation, the economic regulation regime will need to:

31.1 be more flexible than Part 4 of the Commerce Act in relation to the types of economic regulation applied;

31.2 provide for an explicit ability to set performance requirements that extend beyond quality standards;

31.3 provide an ability to use comparative benchmarking to drive challenging targets for cost control (if price regulation is to be required or enabled); and

31.4 provide an effective ability to consider the impacts of economic regulation on the ability of regulated entities to obtain appropriate finance (if price regulation is to be required or enabled).

More flexibility regarding the types of economic regulation applied

32. Given the unique proposed structure and governance of WSEs, and the significant change the sector is likely to face in the coming years, applying economic regulation is likely to involve a process of learning and refinement in the early years.

33. We note that several international economic regulators that deal with non-profit-making regulated entities (similar to WSEs) have altered their approach to regulation over time, which indicates that there is unlikely to be one 'correct' form of regulation to impose on day one. This highlights the potential value in the economic regulator having a range of tools at its disposal so that, once the behaviour and incentives of the regulated entities are understood, the appropriate tools can be deployed and then adapted. For example, while a price path may not need to be imposed initially, flexibility to impose it at a later date could nevertheless be desirable.

34. If MBIE and DIA conclude that more flexibility in the tools of economic regulation would be desirable, one way to achieve this would be to make use of a model similar to that contained in the Retail Payment System Bill (the RPS Bill). Under the RPS Bill, rather than specifying in legislation the form of regulation that applies (as is done under Part 4 of the Commerce Act), the regulator has broad discretion regarding the form of economic regulation to be imposed at any given time. Another regulatory model that provides even greater flexibility is the Electricity Industry Participation Code 2010 produced under the Electricity Industry Act 2010. The Code provides the Electricity Authority with broad discretion regarding the content of the Code, provided that it contributes towards achieving the Electricity Industry Act's objectives.

35. Alternatively, if the preference is to specify the form of regulation that applies in legislation, we recommend that the legislation also provides a clear ability for the form of regulation to be amended over time. We discuss this matter further in response to questions 9A and 9B in Attachment 1.

An explicit ability to set performance requirements that extend beyond quality standards

36. Currently, under Part 4 of the Commerce Act, for entities that are subject to price-quality regulation (for example, the non-consumer-owned Electricity Distribution Businesses (EDBs)), the Commission may set quality standards that cover matters

such as reliability of supply. Quality standards generally seek to incentivise improvements in performance indirectly, by setting outcomes that regulated entities need to meet, which can then drive investment in assets or operational expenditure to meet these outcomes.

37. Given the Government's objectives for three waters services – including in relation to quality, resilience, and efficiency – the Commission recommends that the Government consider a shift from enabling the economic regulator to impose quality standards, to enabling the economic regulator to impose performance requirements. We consider that a shift to the use of performance requirements could be desirable given the likely reduced ability of traditional price-quality regulation to incentivise improvements in performance.

38. Performance requirements could:

    38.1 cover matters that are already clearly within the remit of quality standards as defined under Part 4 of the Commerce Act;

    38.2 explicitly enable a direct mechanism for the economic regulator to impose some requirements that the Commission has previous done somewhat indirectly under Part 4 (either via information disclosure, quality standards, or a price path); and/or

    38.3 provide new tools for improving the performance of regulated entities.

39. The Commission has not yet fully identified the full range of potential performance requirements that could be desirable, nor the situations in which they might be used. This learning gap highlights the potential value in the legislation providing a flexible toolkit that the regulator can deploy as is required. However, we consider that performance requirements could potentially include:

    39.1 **Outcome requirements**. Outcome requirements could cover matters such as aggregate quality, reliability, risk, remaining life, and asset condition. Many of these relate to dimensions of quality and could likely be set as quality standards. However, given the Government's focus on driving high performing WSEs, once the regulator has a strong understanding of the regulated entities, it may determine that there are other necessary outcomes that do not directly relate to quality. A general power to set performance requirements would provide the economic regulator with the flexibility to drive these outcomes and, ultimately, improved performance.

    39.2 **Output requirements**. An output requirement would be an ability to direct specific action by a regulated entity (such as investment in specific assets), rather than only being able to seek these outcomes indirectly via a quality standard. Output requirements could respond to what we understand to be an underinvestment to date in water infrastructure by some suppliers, and counter any lack of incentive to invest in required infrastructure that may result from WSEs' status as monopoly service providers. However, as they are

a significant directive instrument, they would need to be used judiciously by the economic regulator.

39.3 **Financial and cash management requirements.** If WSEs are to be subject to a price path, for a range of reasons, including the inability to pay dividends, it is possible that they could end up with substantial excess cash retained within their businesses. To ensure that such cash is not poorly utilised, the economic regulator could be given the ability to 'ring-fence' a portion of an entity's allowable return, such as the portion that would typically represent the return to equity. Given the inability to pay dividends, this would represent a potential surplus to the WSE. These returns could then be required to be held in reserve (up to a certain limit), effectively forming a financial buffer and to help finance unexpected substantial investment requirements which may arise. Requirements could also extend to, for example, setting certain risk profiles that regulated entities must comply with in respect of their investments.

39.4 **Independent certification requirements.** This could involve requiring that regulated entities receive independent certification regarding certain aspects of their performance. One potential example of what this could cover is in relation to promoting resilience of assets and networks. For example, the regulator could set requirements that WSEs' asset management plans be externally certified as to their sufficiency. Under Part 4 of the Commerce Act, these types of requirements can be imposed indirectly through quality standards and/or information disclosure requirements. However, we consider that explicitly providing for such a tool would provide more certainty and predictability for both the regulator and regulated entities.

39.5 **Cost-benefit analysis requirements.** WSEs could be required to conduct cost-benefit analysis in respect of proposed investments to provide greater certainty that investments represent value for money. Under Part 4 of the Commerce Act, such requirements can, for instance, be imposed as part of requirements for customised price-quality path proposals. However, explicitly providing for such a tool more generally would be beneficial.

39.6 **Engagement requirements**. These could require WSEs to engage with consumers or other stakeholders in a particular manner. This is discussed further in response to question 31 in Attachment 1.

An ability to use comparative benchmarking to drive challenging targets for cost control (if price regulation is to be required or enabled)

40. To date, economic regulation in New Zealand has typically incentivised efficiency gains by allowing regulated entities to keep a portion of any efficiencies achieved in a regulatory period. WSEs' inability to pay dividends may dull their incentives to seek efficiencies (proposed legislative objectives to act in the best interest of customers and communities aside).

41. If price regulation is to be provided for, then to most effectively drive efficiency, the regulator may need to set allowable revenues under any price-quality path to be below existing cost levels.[1] This is facilitated by the ability to incorporate comparative benchmarking into the regulator's considerations.

42. Under Part 4 of the Commerce Act, while we can set revenue paths which incorporate anticipated future cost savings, this can be challenging under a default price path given the prohibition on using comparative benchmarking in the context of a price-quality path. As such, we recommend that comparative benchmarking be permitted, as it is for customised and individual price paths under Part 4, and in many other economic regulation regimes across the world.

An effective ability to consider the impacts of economic regulation on the ability of regulated entities to obtain appropriate finance (if price regulation is to be required or enabled)

43. If price regulation is to be provided for, in setting price-quality paths, the economic regulator can also have an impact on financeability – the ability of an entity to raise sufficient capital (in this case debt) to fund its operations. This is because if the revenue path is too 'tight', then capital markets may choose not to lend to the entity, or only to lend on unfavourable terms.

44. We consider that there are several characteristics of the potential economic regulatory regime for water which suggest financeability concerns may be greater here than for other regulated sectors. These include:

    44.1 WSEs may lack a substantive equity buffer and constraints on raising equity;

    44.2 a failing entity cannot be resold (and refinanced) by a more efficient owner;

    44.3 the likely need for major capital expenditure requirements, with uncertainty as to how much would be funded through debt;

    44.4 a prospect that WSE revenues may be completely dependent on regulatory decisions; and

    44.5 the likely need to place more challenging targets on WSEs to drive efficiency over time (see Paragraphs 41 and 42 above).

45. We recognise that financeability concerns may be distant. However, these conditions can change over time. As such, to the extent that the Government considers it appropriate to provide for price regulation, we consider that the regulator should have the ability to take these issues into account.

46. The Commission can consider issues relating to financeability under Part 4 of the Commerce Act. However, any financeability assessment is limited to the portion of the entity that is regulated, which is somewhat artificial when it comes to the financial position of the business as whole. If WSEs were unrestricted in their ability to also engage in unregulated services – meaning that the economic regulator for

[1] This may also have ramifications such as more intensive information disclosure requirements.

three waters was limited in its ability to take into account financeability when setting a price-path – this could limit WSEs' ability to raise debt to fund required investment, with no alternative capital sources. This could have significant impacts on WSEs' ability to deliver on the Government's reform objectives.

47. In some overseas jurisdictions, financeability is supported through licensing conditions which may restrict the regulated business from engaging in unregulated activities or place other conditions around financing, therefore ensuring that any assessment of financeability of the regulated business is aligned to that of the entity needing finance. This also protects against the regulator being forced to increase revenues solely due to how the regulated entity has chosen to structure its finances or its investments in other businesses. If price regulation were to be imposed, one way to deal with this in the New Zealand context would be to limit through statute WSEs' ability to engage in unregulated activities.

Efficiency gains will likely take some time to achieve

48. In the initial years of any economic regulation regime for three waters services, the focus of the regulated entities is likely to be on the substantial work associated with amalgamating the functions previously performed by a wide range of separate suppliers and gaining a greater understanding of their business, while also seeking to maintain services to consumers throughout the transition. Similarly, the focus of the economic regulator is likely to be on building an understanding of the sector and putting in place foundational rules for the entities.

49. Given this, we caution against expectations of economic regulation driving substantial efficiency gains in the early years of an economic regulation regime. Based on our experience, we consider that a long-term time horizon of five-to-ten years is required for an economic regulatory regime to mature and deliver substantial gains.

We agree with the discussion paper's assessment of the options for institutional arrangements

50. The Commission agrees with the criteria outlined in the discussion paper regarding options for regulatory institutional arrangements for both economic regulation and consumer protection, and with the assessment of the options against these criteria. We understand that Taumata Arowai is also largely in agreement with these criteria and the assessment.

51. In reaching this conclusion, we recognise that there are overlaps between the matters likely to be covered by an economic regulation regime, consumer protection regime and the regime already established under the Water Services Act.

52. We agree with MBIE that factors such as the Commission's experience with economic regulation regimes, and the synergies with other forms of economic regulation, are likely to outweigh synergies associated with bringing together the economic regulation regime and the regime established under the Water Services Act. Similarly, we consider that there are likely to be greater synergies between the

economic and consumer protection regimes being housed within the same regulator, than in the consumer protection regime and regime established under the Water Services Act being within the same regulator.

53. We have a strong relationship with Taumata Arowai, with our Chief Executive having been on the Establishment Board.

Clarify the hierarchy and interrelationship between different regulatory tools and regimes

54. There are a range of different regulatory tools, regimes, and accountability instruments beyond economic regulation that will apply to the proposed WSEs. As with any multi-faceted regime, there is potential for overlap. This includes:

    54.1 the matters likely to be covered by an economic regulation regime, and the regime established under the Water Services Act;

    54.2 the proposed consumer protection regime and proposed economic regulation regime;

    54.3 the proposed consumer protection regime and the regime established under the Water Services Act; and

    54.4 Government Policy Statements, Statements of Strategic and Performance Expectations, and the economic regulation regime.

55. We think that the legislation relating to three waters should minimise overlaps between different regulators and regulatory instruments. Where overlap between the roles and responsibilities of Taumata Arowai and the economic regulation and consumer protection regulator(s) does exist, potential issues can be minimised through:

    55.1 use of consistent terms and definitions in the different pieces of legislation;

    55.2 statutory provisions to enable information sharing;

    55.3 statutory provisions regarding coordination and consultation between regulators; and

    55.4 strong relationships between the different regulators.

Overlap between the economic regulation regime and the regime administered by Taumata Arowai under the Water Services Act

56. We consider that, should the Commission or another entity other than Taumata Arowai be designated as the economic regulator, overlap between the role of Taumata Arowai and that of the economic regulator is manageable. Economic regulation and drinking water quality standards are set by different regulators in England and Wales, Scotland, and the Australian states of New South Wales and Victoria.

57. Examples of where overlap may arise, and how these issues could be addressed, include:

57.1 **Drinking water quality requirements set by Taumata Arowai may have implications for both operational and capital expenditure by WSEs**. If price-quality regulation were to be imposed, the economic regulator would be able to recognise such required expenditure as legitimate costs[2] that would feed into the maximum allowable revenue set. We discuss similar issues below at Paragraphs 72-74 in respect of Te Tiriti o Waitangi and Te Mana o te Wai. The main potential issue is if more stringent drinking water quality standards were introduced *after* a price-quality path was set. This would be manageable if the economic regulator had a statutory mechanism to reopen a price-quality determination to reflect changing costs or at the request of another regulator, as is the case under Part 4 of the Commerce Act.

57.2 **A quality path could overlap with requirements set out in the Water Services Act.** Among other things, the Water Services Act sets out a duty on drinking water suppliers to provide a sufficient quantity of drinking water. It also specifies that any planned restrictions on supply of drinking water should not exceed 8 hours. These are matters that could plausibly also be covered under a quality path under economic regulation. This could be resolved by specifying in the legislation establishing economic regulation that a quality path cannot be set for any matter for which quality standards may be set under the Water Services Act.[3] Alternatively, the legislation could include provisions requiring Taumata Arowai to consult with and take into account the decisions of the other regulator (and vice versa) before making decisions on matters for which there is overlap between the regulators.[4]

57.3 **Reporting requirements under the Water Services Act may overlap with those under an economic regulation information disclosure regime.** The Water Services Act requires Taumata Arowai to monitor and report on the environmental performance of drinking water, stormwater, and wastewater networks to promote transparency and enable comparisons to be made between the performance of different operators (section 141 of the Water Services Act). Taumata Arowai is also required to establish a network register of wastewater and stormwater networks (sections 144-146 of the Water Services Act). These functions share significant similarities with what might be provided for under an economic regulation information disclosure regime (albeit only in relation to environmental performance). We consider that overlap in respect of information disclosure is manageable and could be

[2] By which we generally mean efficient costs of a prudent water services entity. This means an entity following good water industry practice for its asset management subject to other relevant legislative and regulatory constraints, and the willingness to pay of water consumers for certain levels of service quality, as well as any other obligations on the WSE that reflect its operating environment in a New Zealand context.

[3] More analysis would be required to ensure that this did not detract from a coherent economic regulation regime.

[4] For example, see section 54V of the Commerce Act in respect of the Commission's interactions with the Electricity Authority.

resolved by coordination between regulators to ensure unnecessary compliance costs are avoided. This would require an ability in legislation for the regulators to share information with each other – see our response to question 46 in Attachment 1.

Overlap between the economic regulation and consumer protection regimes

58. In respect of potential crossover between the economic regulation and consumer protection regime, there is significant overlap between what could be the subject of a quality path under an economic regulation regime, and what could be the subject of a service quality code under a consumer protection regime. For example, both a quality path or a service quality code could deal with matters such as the time taken to respond to water outages or network faults, and minimum flow or pressure rates.

59. While these matters could be coordinated between differing regulators, we consider that the overlap would be best addressed by having the same regulator responsible for both economic regulation and consumer protection (as is the case under the Telecommunications Act 2001). This would allow the regulator to choose between various tools available to it to achieve a given outcome and reduce the risk of entities being subject to multiple tools and associated enforcement provisions aimed at achieving the same outcome. If responsibilities for economic regulation and consumer protection were to be split between different regulators, we recommend that the scope of any service quality code could be narrowed to exclude matters that could be covered by a quality path under economic regulation.[5]

Overlap between the consumer protection regime and the regime administered by Taumata Arowai under the Water Services Act

60. There is also potential for crossover between the roles and functions of a consumer protection regulator, and those set out for Taumata Arowai under the Water Services Act. This includes an ability for regulations to be made that could require drinking water suppliers to provide any prescribed information to consumers (section 38 of the Water Services Act). Provision of information to consumers is one of the matters envisaged by MBIE as potentially being covered by a service quality code.

61. The information provision power in the Water Services Act does not appear to be limited to matters relating to drinking water. That is, it appears that disclosure could potentially cover stormwater or wastewater services, if these were provided by a drinking water supplier (although we acknowledge this could be narrowed through regulations). If the consumer protection regulator is to be an entity other than Taumata Arowai, this apparent overlap could be resolved by clarifying the matters for which regulations under the Water Services Act relating to information provision may be made, or through coordination between the regulators.

62. There is also potential for overlap between the consumer complaints process outlined in sections 38 and 39 of the Water Services Act and any dispute resolution

[5] Analysis would be required to ensure that this still enabled a coherent consumer protection regime.

process established under a consumer protection regime. In particular (similar to the issue of information provision discussed above), the complaints process under the Water Services Act does not appear to be limited to solely matters of water quality, or drinking water itself. In any case, we recommend that the coverage of any additional three waters consumer disputes resolution scheme be clearly set out in legislation, and that overlap with the processes set up under the Water Services Act be minimised.

Government Policy Statements, Statements of Strategic and Performance Expectations, and the economic regulation regime

63. We note the proposal to require WSEs to give effect to a Government Policy Statement (GPS)[6] and take into account a Statement of Strategic and Performance Expectations prepared by the Regional Representative Group. As such, there are questions regarding the interaction between a GPS issued to WSEs, and any economic regulation regime.

64. We understand that the intent is for the GPS and Statement of Strategic and Performance Expectations to be high-level. However, if these documents were to address matters of detail, particularly relating to pricing or investment, care would need to be taken to ensure that legislation allows the economic regulation regime to readily adapt and take these obligations into account in a timely manner.

65. The Commission's initial view is that economic regulation would be able to factor in the direction issued to a WSE through a GPS or other instruments, to the extent that they overlapped or conflicted. For example, if a GPS specified that entities should undertake very high levels of investment, and if price-quality regulation were to be imposed, then the economic regulator would generally be able to allow for such investment when setting a price-quality path, with its focus on whether such obligations were given effect to in an efficient way. However, to allow for this, the economic regulator would need a statutory ability to reopen a price-quality determination.

The economic regulation and consumer protection regime can and should be sufficiently flexible to take into account Te Tiriti o Waitangi and Te Mana o te Wai

66. The discussion paper raises questions of legislative objectives relating to Te Mana o te Wai and the role of Te Tiriti o Waitangi in the design of economic regulation and consumer protection regimes for three waters.

67. The Commission considers it important that any economic regulation or consumer protection regime is responsive to Te Tiriti o Waitangi and reflects Te Mana o te Wai. This is important not only for promoting Māori-Crown relations, but also to promote regulatory coherence, given the statutory objectives regarding Te Mana o te Wai set out in the Water Services Act.

[6] As distinct from whether the economic and consumer protection regulator would have to have regard to statements of government policy (see our response to question 45 in Attachment 1).

68. Our key feedback in respect of this issue is set out below. In summary:

68.1 the Commission is building its Te Ao Māori capability and strategy;

68.2 price-quality regulation can take Te Tiriti o Waitangi and Te Mana o te Wai into account; and

68.3 considerations relating to Māori historic price and service inequality would best be addressed by Government.

The Commission is building its Te Ao Māori capability and strategy

69. The discussion paper asks questions about the cultural competency of the economic regulator to recognise the significance of water as a taonga for Māori. It also tentatively identifies the Commission as the preferred economic and consumer protection regulator.

70. The Commission is committed to building its understanding of its role as a Treaty partner under Te Tiriti o Waitangi. We are beginning a journey to better understand Te Ao Māori and what it means for our work. For example, the Commission has recently held its first engagement hui, He Kohinga Kōrero, in the context of the retail grocery sector market study. We have recently appointed, jointly with the Office of the Privacy Commissioner, a Principal Adviser – Māori, who will lead the Commission's development on these matters, and are developing a Māori strategy to inform our work.

71. It is our view that the work of the economic regulator in relation to three waters requires a commitment to Te Tiriti o Waitangi and Te Ao Māori. The Commission is beginning its journey to give effect to this commitment.

Price-quality regulation can take Te Tiriti o Waitangi and Te Mana o te Wai into account

72. If the Commission was the economic regulator, and a form of price-quality regulation were imposed, it is likely that we would be able to take into account expenditure obligations that arise as a result of Te Tiriti o Waitangi or Te Mana o te Wai. This could include if, for example, an obligation to give effect to Te Mana o te Wai is interpreted to mean that a higher level of investment is required in water services infrastructure.

73. In considering such expenditure, we expect that we would undertake some form of assessment as to whether a good process has been undertaken for determining how to respond to such obligations, and whether costs for a chosen solution appear reasonable. We would not expect to undertake significant assessment as to whether the expenditure is actually necessary.

74. The Commission considers that the economic regulator would be able to take into account such matters without an explicit statutory objective. If Government considers that the economic and consumer protection regulator should be subject to additional direction regarding Te Tiriti o Waitangi and/or Te Mana o te Wai, we

would welcome the opportunity to work with MBIE and DIA on how this best be given effect.

Considerations relating to Māori historic price and service inequality would best be addressed by Government

75. The discussion paper seeks feedback on how Māori historic experience of both price and service quality inequity, and Māori being over-represented in groups with fixed income being more vulnerable to price shocks, could be accounted for under an economic regulation and consumer protection regime. The Commission considers that these matters could (to a certain degree) be addressed through provisions that allow any requirements in a service quality code to vary for different types of consumers (see our response to questions 25 and 26 in Attachment 1).

76. To the extent that Government considers that Māori should face different prices or pricing structures, the Commission recommends that the Government (rather than the economic regulator) have responsibility for setting these pricing structures or levels, given its ability to make judgments on matters of equity (see also our response to questions 14A, 14B and 14C in Attachment 1).

Attachment 1: Specific answers to discussion paper questions

Q1: What are your views on whether there is a case for the economic regulation of three waters infrastructure in New Zealand?

78. The Commission agrees with MBIE that three waters infrastructure shares many of the characteristics of natural monopolies that are typically subject to economic regulation. As we understand it, there is generally no competition in the supply of drinking water, wastewater, or stormwater services, and no likely prospect of competition emerging. Further, as the discussion paper notes, it is unlikely that competition in the supply of such services would be efficient, given the very high costs of providing the required infrastructure.

79. More fundamentally, whether economic regulation should be introduced ultimately flows from the Government's policy objectives for three waters infrastructure. As set out in the body of our submission, the Commission does not have a position on these objectives. However, the Commission considers that economic regulation of some form may be able to support the Government to achieve its objectives.

Q2: What are your views on whether the stormwater networks that are currently operated by local authorities should be economically regulated, alongside drinking water and wastewater?

80. The Commission does not have a position on whether stormwater should be subject to economic regulation. In terms of the technical and practical implications, either inclusion *or* exclusion of stormwater assets would create practical challenges for the economic regulator.

81. In particular, the regulator would face the challenge of defining the scope of the regulated stormwater service and identifying and defining the regulated entity's stormwater assets – either to bring them within the scope of the economic regulation regime, or to rule them out. In either situation, there will also be issues relating to the allocation of common costs; all that would change is the nature of what is considered 'common'. Beyond this, as the discussion paper notes, if stormwater were to be regulated, there would be challenges associated with determining which operating costs relating to maintenance can be expensed.

82. Given that there will be practical difficulties either way, we recommend that the decision about whether to regulate stormwater be made in the context of which option best achieves the Government's objectives in respect of three waters, rather than determined on the basis of practical or technical considerations.

Q3: What are your views on whether the four statutory Water Service Entities should be economically regulated?

83. Whether or not the four proposed WSEs should be economically regulated is ultimately a policy decision for the Government. However, the Commission agrees with MBIE that consumer involvement in the governance of natural monopolies is best seen as a complement to, rather than a substitute for, economic regulation.

84. The proposed ownership and governance structure of WSEs differs from that of consumer-owned EDBs. However, we note that the Government has seen fit to apply economic regulation (albeit information disclosure regulation only) to consumer-owned EDBs, despite the ownership by consumer trusts meaning that EDBs do not have a strictly commercial focus.

85. While the proposed structure and governance model for WSEs may reduce the incentive to, for example, extract excess profits from consumers, there are some elements of the proposed structure and governance of WSEs that may strengthen the case for economic regulation. For example, the proposed public ownership model and corresponding lack of capital market disciplines may reduce the incentives for WSEs to be efficient. Economic regulation, if designed and implemented well, has the potential to help compensate for this.

86. To the extent the Government concludes that the four WSEs should be subject to economic regulation, we support this being specified in legislation, rather than requiring a further inquiry or designation process by the regulator (see also our response to question 9A below).

Q4: What are your views on whether economic regulation should apply to community schemes, private schemes, or self-suppliers? Please explain the reasons for your views.

87. While we have not conducted any detailed analysis on this point, the Commission agrees with MBIE that none of the community or private schemes, or self-suppliers, are currently likely to be of a scale at which the benefits of economic regulation would outweigh the costs.

88. However, as discussed in response to question 9A below, we consider that there should be a flexible process in which the economic regulator may recommend to the Minister that economic regulation be extended beyond the entities initially specified in legislation. This will allow the regulatory regime to respond to developments in the water sector over time.

Q5: What are your views on whether the Water Service Entities should be subject to information disclosure regulation?

89. Whether WSEs are able to be subject to information disclosure regulation is ultimately a policy matter for Government. However, as set out in the body of our submission, we consider that – given the novel proposed structure and governance model of WSEs – it may be desirable for the economic regulator to have discretion as to the form of economic regulation that is applied.

90. The Commission's experience with economic regulation to date is that information disclosure regulation can be a powerful tool to improve the performance of regulated businesses, including by:

    90.1 improving regulated entities' understanding of their own business; and

    90.2 providing incentives for better performance by creating transparency and allowing for external scrutiny.

91. Information disclosure regulation can be a particularly powerful tool to drive change when backed by the threat of more heavy-handed regulation, as has been the case with the information disclosure regulation regime for specified airport services under Part 4 of the Commerce Act.

92. Information disclosure regulation can help resolve information asymmetries and address principal-agent issues that may arise between the owners, board, and/or management of an entity. This can help drive improvements in productivity of the entity and help drive delivery of the entity's strategic objectives.

93. Information disclosure regulation may have particular benefits in respect of the proposed WSEs. For example, the proposed multiple layers of governance of WSEs suggests that, in the absence of information disclosure regulation, there may be greater-than-typical scope for information asymmetries and/or principal-agent issues to arise. In addition, information disclosure regulation may help to address what we understand to be a general lack of good-quality information about the performance of, and investment requirements for, suppliers in New Zealand at present. Information disclosure regulation may also take on increased importance for WSEs given the more limited impact that traditional incentives-based price-quality regulation may have on driving efficiencies, as discussed in the body of our submission.

94. While information disclosure regulation may have real benefits for the proposed WSEs, the lack of high-quality information and the significant time that it will take for entities to complete the process of amalgamation and transition means that information disclosure regulation may take longer to deliver on its full potential than is typical.

Q6: What are your views on whether Water Service Entities should be subject to price-quality regulation in addition to information disclosure regulation?

95. Whether WSEs are able to be subject to price-quality regulation is ultimately a policy matter for Government.

96. As discussed above, the proposed legislative objectives and inability of WSEs to pay dividends may remove any incentive to extract excess profits from consumers. This removes one of the typical rationales for introducing price-quality regulation. Furthermore, while the lack of competition faced by each WSE and the inability to pay dividends may blunt incentives to drive efficiencies absent regulation (potentially indicating a role for a form of price control), the inability to pay dividends also removes the incentive that price control would typically provide for driving efficiencies. This potentially weakens one of the other primary rationales for price regulation.

97. Some elements of what normally form part of a price path – including scrutiny of proposed expenditure – should be able to be achieved through other mechanisms including an enhanced information disclosure regime, potentially complemented by some form of performance requirements. However, we also recognise that there are benefits associated with retaining flexibility to impose price regulation once more is

known about the behaviour and incentives of regulated entities. As such, we recommend that consideration be given to whether the economic regulator should have discretion as to the form of economic regulation applied to regulated entities. We also consider that some additional or amended tools relative to those provided for under Part 4 of the Commerce Act may be desirable.

98. To the extent that the Government does consider price regulation to be desirable, the Commission considers that it could have the following secondary benefits:

98.1 providing additional levers to scrutinise expenditure (via an approval function) compared to those available under information disclosure regulation alone;

98.2 providing comfort to customers that they are not overpaying for services; and

98.3 providing an ability to smooth costs over time and minimise price shocks (while still providing confidence to lenders about WSEs' financeability over the long term).

99. In terms of quality regulation, the underinvestment in water assets to date by current suppliers, coupled with the monopoly status of the entities, suggests that some form of quality regulation may be desirable. As discussed in the body of our submission, we recommend consideration be given to extending the toolkit of the economic regulator beyond quality standards to also enable the regulator to impose a broader set of performance standards, if the regulator considers it desirable. These could relate to matters such as specific outcomes, outputs, engagement, independent certification, cost-benefit analysis, and/or cashflow and financial management.

Q7: What are your views on the appropriateness of applying individual price-quality regulation to the Water Service Entities?

100. Given the small number of proposed WSEs, if price-quality regulation is to be applied, the Commission agrees that a form of individual price-quality regulation would be the most appropriate form of regulation to apply.

101. The Commission considers that individual price-quality (albeit modified from the form provided for under Part 4 of the Commerce Act) regulation provides the best opportunity to tailor the form of regulation to the specific circumstances of each WSE, and thus the best opportunity to drive improvements in performance of each of the entities. As discussed in the body of our submission, it also provides greater scope for setting challenging targets for cost control based around comparative benchmarking.

Q8A: Do you consider that the economic regulation regime should be implemented gradually from 2024 to 2027, or do you consider that a transitional price-quality path is also required?

Q8B: If you consider a transitional price-quality path is required, do you consider that this should be developed and implemented by an independent economic regulator, or by Government and implemented through a Government Policy Statement?

102. The Commission supports a graduated approach to implementing economic regulation. Introducing economic regulation to a sector is a significant undertaking, and it can take significant time for the economic regulator to build an understanding of the soon-to-be regulated entities and design an appropriate regulatory regime around them. In the case of water, this will be complicated by the fact that the proposed new WSEs will be in establishment phase and building an understanding of their own businesses for several years after the proposed establishment date of 1 July 2024.

103. Given this, while the Commission supports the general phasing proposed for the introduction of a conventional price-quality path as set out in the discussion paper, we consider that the timeline is relatively ambitious and represents the earliest dates at which such a conventional cost-based price-quality path could credibly and effectively be imposed. Bringing forward the dates would compromise the ability of an economic regulator to develop a well-reasoned, evidence-based regime and could have unintended consequences for consumers. As noted in the discussion paper, an earlier implementation date could result in key elements of the regulatory regime being developed either without the regulated entity being able to contribute to the process, or unable to contribute effectively without undermining its other establishment-phase operations.

104. As a parallel, we note that the Commission was initially given just over one year under the Telecommunications (New Regulatory Framework) Amendment Act 2018 to develop both input methodologies and price-quality and information disclosure determinations. After exercising provisions in legislation which allowed the responsible Minister to extend the implementation date by up to two years, we have now had just over three years to develop these elements of the regime. Based on this experience, we consider three years to be the minimal viable time necessary to implement a regime of this nature.

105. Whether a transitional price path is introduced is ultimately a policy call for Government. However, we caution that – if developed by the economic regulator – a transitional path risks distracting both the regulator and the regulated entity from the process of developing a conventional price-quality path.

106. If a transitional path was to be set by the Government, we recommend that significant care be taken to ensure that such a path does not have unintended consequences. If a transitional path is developed, there is a risk that it is inadvertently too constraining on the regulated entity, with corresponding implications such as underinvestment in infrastructure. Alternatively, if set too generously, it could lead to undesirable price rises for consumers. One way to deal

with this would be to allow for wash-ups and clawbacks[7] once the full economic regulation regime is in place.

107. If the Government concludes that a transitional price path should be set, the Commission recommends that consideration be given to an approximated price-quality path based on rolling over existing prices, plus CPI adjustments. This is because, compared to a cash-based price-quality path or approximated cost-based path using a building blocks approach, it is potentially the least likely to have unintended consequences for a given level of regulatory effort.[8] However, even rolling over existing prices plus a CPI adjustment has the potential for unintended consequences. For example, given the publicly available estimates about the extent of investment required in three waters infrastructure, simply rolling over existing prices for a period of time could constrain WSEs' ability to invest in necessary upgrades to their networks if this impacted on their ability to obtain finance.

Q9A: What are your views on whether the Minister of Commerce and Consumer Affairs should be able to reduce or extend the application of regulation on advice from the economic regulator?

108. The Commission supports the legislation providing flexibility for the Minister of Commerce and Consumer Affairs to reduce or extend the application of regulation on advice from the economic regulator. We think that the legislation could allow for:

    108.1 the application of economic regulation to water services suppliers that are not specified in legislation as being subject to economic regulation; and

    108.2 the removal of economic regulation from a water services supplier that is currently subject to economic regulation, regardless of whether economic regulation was imposed via an Act of Parliament or an Order in Council.

109. In terms of the form of regulation applied, as discussed in the body of our submission, the Commission recommends that consideration be given to the economic regulator being given greater discretion to determine which form of economic regulation should apply to entities subject to economic regulation. This could follow a model similar to that set out in the RPS Bill, in which, once a retail payments network is designated,[9] the Commission may determine whether to apply information disclosure, price, and/or access regulation, and the form of this regulation. An alternative would be for the economic regulator to recommend to the

[7] Adjustments to allowable revenues in subsequent regulatory periods to account for differences in actual versus expected costs and revenues.

[8] That is, while a cash-based or approximated cost-based building blocks transitional price-quality path may be able to be implemented with fewer unintended consequences, they would require a higher level of resource to do so, which could detract from efforts to develop a conventional price-quality path.

[9] As discussed in response to question 4, we consider that the four WSEs could be deemed subject to economic regulation via statute rather than requiring the regulator to undertake a separate designation or inquiry process.

responsible Minister the form of regulation to be introduced, which the Minister would need to approve.

110. To the extent that the Government's preference is to specify the form of economic regulation that applies to entities in legislation, the Commission recommends that the legislation provide a process for the imposition of a different form of regulation on regulated suppliers, regardless of whether the method of regulation is specified in an Act of Parliament or an Order in Council.

111. While broader than what MBIE appears to envisage, we consider that such settings would help enable a flexible and responsive regulatory regime.[10] In our view, having the Minister of Commerce and Consumer Affairs as decision-maker, and the inclusion of statutory decision-making criteria (discussed below), provide sufficient safeguards for these provisions.

Q9B: What factors do you consider the economic regulator should include in their advice to the Minister?

112. We generally support the matters included in the discussion paper that the economic regulator would have to take into account in its advice to the Minister. However, we recommend that the reference to benefits and costs are framed as *likely* benefits and costs, to reduce the evidential burden associated with extending or reducing regulation. We also consider that it could be appropriate for the regulator to refer to the purpose of the economic regulation regime before providing advice.

113. We also note that, under Part 4 of the Commerce Act, when undertaking a Part 4 inquiry or an inquiry into regulation of specified airport services, the Commission is required to provide recommendations in relation to matters including:

113.1 what input methodologies apply;

113.2 if information disclosure regulation is recommended, the material provisions of the information disclosure requirements;

113.3 if negotiate/arbitrate regulation is recommended, the material provisions of the negotiation process and arbitration process;

113.4 if default/customised price-quality regulation is recommended, the default price path and quality standards; and

113.5 if individual price-quality regulation is recommended, the material provisions to apply.

114. While we recognise that such provisions help to ensure that a cost-benefit assessment is undertaken with a good understanding of what a regulatory regime

[10] We also note that, in the context of electricity, the Electricity Price Review recommended more flexibility for the Commission to recommend changes to the form of regulation applied. See: Electricity Price Review (2019). *Final Report*. Retrieved from: https://www.mbie.govt.nz/assets/electricity-price-review-final-report.pdf

would look like, we note that such obligations increase the cost of undertaking inquiries, and potentially reduce the flexibility and dynamism of the regime. As such, for water, we recommend consideration be given to focusing the analysis the regulator is required to undertake on the tests outlined at paragraph 90 of the discussion paper.

Q10A: What are your views on whether the purpose statement for any economic regulation regime for the water sector should reflect existing purpose statements in the Telecommunications Act 2001 and Part 4 of the Commerce Act 1986 given their established jurisprudence and stakeholder understanding?

115. The Commission supports mirroring the purpose statements contained in the Telecommunications Act and Part 4 of the Commerce Act, for the reasons set out in the discussion paper. We consider that altering the language of the purpose statement risks reducing the ability of the economic regulator for water and regulated entities to draw on existing precedent, which could undermine the stability and certainty associated with the regime.

116. In the discussion paper's section on efficiency challenges, MBIE seeks feedback on whether the reference to 'incentives to improve efficiency' in the purpose statement of Part 4 of the Commerce Act is sufficiently broad to also encompass active – rather than simply passive – efficiency challenges. The Commission agrees with MBIE that such a purpose statement can be read broadly to encompass active efficiency challenges.

Q10B: What are your views on whether the sub-purpose of limiting suppliers' ability to extract excessive profits should be modified or removed given that Water Service Entities will not have a profit motive or have the ability to pay dividends?

117. The Commission supports retaining the sub-purpose relating to excessive profits. While WSEs will not be able to pay dividends, as we understand it the entities will still be able to earn a surplus. As such, we consider that the limb relating to excess profits is still relevant. In addition, as above, removing a limb of the purpose statement risks reducing the ability of the regulator, and regulated entities, to draw on existing jurisprudence relating to Part 4 of the Commerce Act.

Q10C: Are there any other considerations you believe should be included in the purpose statement, or as secondary statutory objectives?

118. Matters relating to Te Mana o te Wai and Te Tiriti o Waitangi are addressed in the body of our submission.

119. In respect of other matters such as climate change, under section 5ZN of the Climate Change Response Act 2002 and Part 4 of the Commerce Act, the Commission can take into account matters such as climate change where these are relevant to our decision-making role, so long as they complement the statutory purpose of Part 4. Similarly, we expect that any price-quality path set by the economic regulator would likely be able to take into account expenditure by WSEs to, for example, improve resilience against matters such as sea-level rise, provided doing so was consistent with the statutory purpose of the economic regulation regime.

120. Providing the economic regulator with an explicit, high-level objective to have regard to matters such as climate change could create uncertainty as to the impact and extent of such an obligation, and create difficulties in balancing this objective with the overall purpose (providing this purpose is carried over to any three waters legislation) of promoting the long-term benefit of consumers. As such, if objectives relating to climate change or other factors are to be provided for in the economic regulation legislation for water, we recommend that the legislation be specific as to the contexts in which this should apply, and how this should be balanced against other legislative objectives.

Q10D: What are your views on how Treaty of Waitangi principles, as well as the rights and interests of iwi/Māori, should be factored into the design of an economic regulatory regime for the three waters sector?

121. Our response to this question is addressed in the body of our submission.

Q11: What are your views on whether a sector specific economic regulation regime is more appropriate for the New Zealand three waters sector than the generic economic regulation regime provided in Part 4 of the Commerce Act?

122. We agree that a sector-specific economic regulation regime is likely to be more appropriate for three waters than Part 4 of the Commerce Act.

123. As discussed in the body of our submission, we consider that the proposed structure and governance of WSEs means that a broader set of economic regulation tools will be required than are currently provided for under Part 4. We also consider it desirable that the economic regulator be given more flexibility as to the form of economic regulation that is applied.

124. We also consider that, given the proposals for water sector-specific consumer protection provisions, it would be advantageous from a legislative design perspective for any sector-specific consumer protection provisions to sit alongside the economic regulation provisions. We do not consider the Commerce Act (or other existing legislation) to be a natural fit for water-sector-specific consumer protection provisions.

Q12: What are your views on whether the length of the regulatory period should be 5 years, unless the regulator considers that a different period would better meet the purposes of the legislation?

125. The Commission supports a default regulatory period of 5 years, with flexibility to set a regulatory period as short as 2 years or as long as 7 years – both for the initial regulatory period and any subsequent period.

126. We support having the ability to set a short regulatory period for the reasons set out in the discussion paper. A shorter regulatory period may also support the regulatory regime to adapt to developments or uncertainty in a sector. A regulatory period in excess of 5 years is unlikely to be required in the short term. However, it may be appropriate once the economic regulation regime for water has reached maturity, and could reduce costs for regulated entities and consumers.

Q13A: What are your views on whether the economic regulator should be required to develop and publish input methodologies that set out the key rules underpinning the application of economic regulation in advance of making determinations that implement economic regulation?

127. The Commission understands and is supportive of the overall rationale for input methodologies (IMs) as a way of providing upfront certainty to regulated suppliers and other interested parties. As the discussion paper notes, decisions on matters such as valuation of assets, cost of capital, allocation of common costs and treatment of taxation are unavoidable, regardless of whether IMs are formally required or not. As such, the Commission considers that the benefits of formally requiring IMs on these matters outweigh the costs.

128. However, this is only likely to be the case in relation to matters for which an IM is likely to remain relatively stable, and not in need for frequent revision. If an IM needs to be revised every time a determination is made, then the value of the IM is substantially reduced, while the added cost of the IM as a separate process step from the determination remains. IMs are also much less valuable when they relate to matters of regulatory processes and rules. This is because, in the context of Part 4 of the Commerce Act, these are specific to setting a particular price-quality path, and so it may be justified to consider amending them in advance of each reset. The value of an IM to promote certainty for these matters is therefore of significantly less value than the fundamental financial IMs mentioned above. Given this, we recommend that any legislative requirements for IMs be tightly constrained, in line with the matters outlined in the discussion paper.

129. Because of the high level of iteration that is likely to be needed to develop and refine a workable and effective economic regulation regime for water over the first few years, we also recommend that consideration be given to providing the regulator with flexibility over whether to develop separate IMs in the first regulatory period. IMs could be made mandatory for the second and subsequent periods. Imposing requirements for IMs in the first regulatory period could lead to delays in the imposition of economic regulation, or alternatively, increase the risk of an ineffective regime being implemented.

130. An example of where being constrained to set IMs early on could have unintended consequences relates to the regulatory asset base. The regulatory asset base is informed by a number of IMs including those relating to asset valuation and allocation of common costs. Given the nature of the proposed WSEs and the sector, including poor historic data and no equity investors, the economic regulator may decide that the regulatory asset base should be determined based on the initial debt of the WSE, or reverse engineered based on investment requirements. If IMs were set in advance, this would make it much more difficult to apply such an approach.

Q13B: What are your views on whether the economic regulator should be able to minimise price shocks to consumers and suppliers?

131. To the extent that price-quality regulation is to be provided for under the economic regulation regime, the Commission supports the economic regulator having an ability to minimise price shocks to consumers. This can reduce financial hardship for consumers and help to promote confidence in the regime.

132. The Commission supports the discussion paper's proposed approach to minimising price shocks, which mirrors section 197 of the Telecommunications Act. This provides an ability to smooth prices across regulatory periods, while also giving regulated entities confidence that they can recover their investments.

133. For completeness, the Commission would not support addressing price shocks through other mechanisms, such as a starting or transitional pricing IM. Such an IM would not promote certainty, but, on the contrary, could actually increase the risk of price shocks. This is because until the IM was applied, it would be difficult to understand its impacts on pricing. It would also be a 'one-off' IM, which would undermine the intended purpose of IMs of promoting certainty on an ongoing basis as to how economic regulation applies.

Q13C: What are your views on whether the economic regulator should be required to set a strong efficiency challenge for each regulated supplier? Would a strong 'active' styled efficiency challenge potentially require changes to the proposed statutory purpose statement?

134. As discussed in the body of our submission, if price-quality regulation is to be provided for, the Commission supports the economic regulator having an effective ability to set challenging targets for cost control, with the aim of driving efficiency gains amongst regulated entities.

135. However, we have some reservations regarding the form of active efficiency challenge tools suggested in the discussion paper. Given the proposed structure of WSEs (including their inability to pay dividends), requiring regulated entities to compensate consumers if they did not achieve active efficiency targets could either lead to this compensation being funded by consumers themselves (negating any benefit), or through reduced investment in infrastructure.

136. Similarly, while non-financial incentives (such as fast-track investment approvals) could be useful in some circumstances, requiring incentives as a reward for meeting efficiency challenges could unduly constrain the regulator, or lead to it needing to 'cut corners' in its approval role.

137. As such, while we support the regulator having the ability to set efficiency challenges, we recommend that the form of such challenges and the situations in which they are used be left to the regulator's discretion.

Q14A: What do you consider are the relevant policy objectives for the structure of three waters prices? Do you consider there is a case for parliament to directly control or regulate particular aspects in the structure of three waters prices?

Q14B: Who do you consider should have primary responsibility for determining the structure of three waters prices:

- **The Water Services Entity, following engagement with their governance group, communities, and consumers?**
- **The economic regulator?**
- **The Government or Ministers?**

Q14C: If you consider the economic regulator should have a role, what do you think the role of the economic regulator should be? Should they be empowered to develop pricing structure methodologies, or should they be obliged to develop pricing structure methodologies?

138. The Commission does not have view on the appropriate policy objectives for the structure of three waters services pricing. However, we note that the Government's overall objectives in respect of three waters services are underpinned by objectives relating to efficiency and equity.

139. It is not clear what approach each WSE would take to pricing structures in the absence of regulation. However, in respect of efficiency, it is possible that WSEs would choose to price in a manner that did not maximise efficiency. Given this, it may be beneficial for the economic regulator to be *able* to set pricing principles or impose controls on pricing structures, if the regulator considers that doing so would improve efficiency. However, we do not consider that the economic regulator should be *required* to impose controls on the structure of prices on efficiency grounds. This is because we consider it appropriate to allow the regulator to assess the efficiency of pricing structures prior to imposing regulation on such structures. We also note that the regulator may be limited in its ability to impose pricing structures to the extent that water meters are not universally installed.

140. In terms of equity, we consider that what is equitable is, in large part, a matter of subjective assessment. For example, some may consider geographically differentiated pricing to be equitable to the extent that it is driven by differences in costs faced by WSEs to service different communities. Others may consider geographically averaged pricing to be equitable given that all consumers face the same pricing. Giving the divergent views about what is equitable, if Government considers it desirable to promote equity, it may be more appropriate for the Government to address this, rather than the economic regulator.

141. If the Government (rather than the economic regulator) is empowered to set controls on pricing structures, we recommend that these be designed carefully and with the input of the economic regulator. If controls are imposed too rigidly, they may undermine or conflict with any price-quality (revenue) path set under the economic regulation regime, or have other unintended consequences.

142. If both the Government and regulator are empowered to set controls on pricing methodologies, we recommend that legislation clearly specify which regulatory instrument is subordinate to the other, to the extent that they are in conflict.

Q15: What are your views on whether merits appeals should be available on the regulators decisions that determine input methodologies and the application of individual price-quality regulation?

143. The Commission supports merits appeals being available on decisions that determine IMs and the application of individual price-quality regulation. As the discussion paper outlines, these appeals are available for the equivalent processes under Part 4 of the Commerce Act and Part 6 of the Telecommunications Act. Other Commission determinations (such as in relation to mergers and acquisitions) are also subject to merits review and we consider that the availability of merits review can help promote confidence in the regulator and regulatory regime.[11]

144. The Commission agrees with MBIE that merits appeals should not be available on the regulator's determinations that implement more procedural processes, such as information disclosure regulation.

145. In terms of the settings that apply to merits appeals, the Commission strongly supports retaining the 'materially better' threshold that exists in the Commerce Act and Telecommunications Act in respect of IMs. We agree that the materially better threshold helps avoid frivolous appeals and regulatory uncertainty. We also support the retention of the closed record. This should help ensure that the regulator is making its decisions based on the best information being put before it rather than appellants holding back information for the purposes of seeking a different decision from the appellate body.

Q16: Do you broadly agree that with the compliance and enforcement tools proposed above? Are any additional tools required?

146. The Commission's approach to enforcement in respect of non-compliance with legislative obligations and the Commission's determinations is driven by a number of factors. These include the extent of harm associated with the non-compliance, the seriousness of conduct, and the extent to which there is a public interest in the Commission taking enforcement action. As such, the Commission supports the economic regulator having a full suite of compliance and enforcement tools available to it, along the lines of those envisaged in Table 4 of the discussion paper.

147. Having said this, given the inability of WSEs to pay dividends, and the implications this has for who faces the burden of penalties imposed, it is possible that the economic regulator would more frequently seek penalties in respect of individuals rather than in respect of the entity itself. We also expect that the economic regulator would seek to make relatively greater use of reputational mechanisms to incentivise compliance.

[11] We note, however, that there are not merits appeals for decisions made by the Electricity Authority in respect of the Electricity Industry Participation Code.

148. Despite the implications that an inability to pay dividends has for the use of financial penalties, we consider it important that financial penalties are nevertheless included in the regulator's toolkit, as, amongst other things, their presence alone may help to incentivise compliance. In addition, the negative publicity associated with imposition of financial penalties can be a powerful incentive for entities to improve performance, which can outweigh the initial negative impact a financial penalty may have on consumers

Q17: Who do you think is the most suitable body to be the economic regulator for the three waters sector? Please provide reasons for your view.

149. Our response to this question is addressed in the body of our submission.

Q18: What are your views on whether the costs of implementing an economic regulation regime for the three waters sector should be funded via levies on regulated suppliers?

150. The Commission is generally supportive of the notion that the costs of economic regulation should be borne by those who benefit. We note that, with the exception of fuel, all of the Commission's existing economic regulation functions are funded by levies on regulated suppliers.

Q19: Do you think that the levy regime should:

A) Require the regulator to consult on and collect levy funding within the total amount determined by the Minister? OR

B) Require the Ministry to consult on the levy (on behalf of the Minister) and collect levy funding within the total amount determined by the Minister?

Q20: Are there any other levy design features that should be considered?

151. If a levy regime is adopted, the Commission recommends that a model as close to that provided for in section 53ZE of the Commerce Act be adopted. The Commission has found this model to work well in respect of our functions undertaken under Part 4 of the Commerce Act. In particular, the fact that the Commerce Act only requires consultation with regulated parties to be undertaken prior to the making of regulations, rather than yearly (as was the case up until recently under the Dairy Industry Restructuring Act 2001), helps to streamline and simplify the levy process. We recommend that MBIE has responsibility for levy administration including calculations, as it does under Part 4 of the Commerce Act and the Telecommunications Act.

Q21A: What are your views on whether additional consumer protections are warranted for the three waters sector?

152. As with economic regulation, whether additional consumer protections are warranted is ultimately a judgment for Government to make. However, as noted in the body of our submission, we consider that sector-specific consumer protection regulation may support the Government to achieve its objectives in respect of three waters services. In particular, a consumer protection regime could support achievement of the objective of ensuring all New Zealanders have equitable access to affordable three waters services. We note that the discussion paper floats the

possibility of a consumer protection regime applying to a broader range of suppliers than any economic regulation regime.

153. As outlined in the discussion paper, water services will be subject to the general consumer protections offered by the Fair Trading Act 1986 and the Consumer Guarantees Act 1993. This includes the Fair Trading Act's provisions regarding unfair contract terms, and the Consumer Guarantees Act's statutory guarantees regarding reasonable care and skill and fitness for purpose of services.

154. However, given WSEs' monopoly status, the Commission considers that a sector-specific consumer protection regime in new legislation may complement the role of generic legislation by helping to combat inertia or a lack of incentive on WSEs' part to provide high-quality services to their customers. It will also allow for protections to be tailored to issues that are industry-specific – unlike the general protections under the Fair Trading Act and the Consumer Guarantees Act. While a statutory objective to act in the best interest of consumers and communities is helpful, it is unlikely to fully substitute for the role competition can play in terms of incentives for entities to provide high-quality customer service.

155. The other reason the Commission considers that bespoke consumer protection provisions may help to achieve the Government's objectives in respect of three waters is because there is a potential for significant synergies between the matters that can be covered through a quality path imposed under economic regulation, and the matters that may be covered under a consumer protection regime. As such, the economic regulation and consumer protection regimes may best be considered not as two separate regulatory regimes, but as an integrated set of tools that seek to improve the performance of regulated entities and drive better outcomes for consumers.

Q21B: What are your views on whether the consumer protection regime should contain a bespoke purpose statement that reflects the key elements of the regime, rather than relying on the purpose statements in the Consumer Guarantees Act and Fair Trading Act? If so, do you agree with the proposed limbs of the purpose statement?

156. The Commission supports a purpose statement to guide the interpretation and implementation of any consumer protection regime.

157. Given the significant potential for overlap between the economic regulation and consumer protection regimes, we recommend that consideration be given to an integrated purpose statement that covers both the economic regulation and consumer protection provisions for water. For example, the proposed second limb of the purpose statement for economic regulation:

> *have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*

overlaps with the proposed initial limb of the consumer protection regime[12]:

enhancing the quality of water services over time

158. If separate purpose statements are provided for economic regulation and consumer protection, the Commission is broadly supportive of the limbs outlined in the discussion paper. However, we recommend that reference to "enhancing the quality of water services over time" be amended to mirror the language proposed for economic regulation of "provide services at a quality that reflects consumer demands". This will aid consistency with the economic regulation regime, removing scope for contrasting interpretations from different wording. It also places the focus on meeting consumer expectations, rather than requiring infinite improvements in quality, given that at some point along the quality spectrum consumers may prefer lower prices to very high quality.

Q22: What are your views on whether the consumer protection regulator should be able to issue minimum service level requirements via a mandated code that has been developed with significant input from consumers?

159. As discussed above, the Commission considers that a service quality code may support the Government's objectives regarding three waters by working alongside an economic regulation regime to provide a broader set of tools to drive improvements in the performance of regulated entities. Our experience in telecommunications is that having the ability to issue a service quality code is a useful tool to address failures in consumer protection, even if that tool may not always need to be deployed.

160. The Commission does not have a position on what matters should be covered by a service quality code. However, we recommend that the legislation be clear as to what matters it may and may not cover. We note that some of the potential gaps in the regulatory regime identified by MBIE at paragraph 168 of the discussion paper could potentially be covered by a quality path under an economic regulation regime. This includes:

160.1 the time taken to respond to water outages or network faults, and the notice periods for planned interruptions to supply;

160.2 information about network status, including damage or disruption due to flooding or weather events, and the obligations of the supplier to communicate to consumers; and

[12] Although we acknowledge that the discussion paper notes that this would focus on aspects of quality not regulated by public health, environmental or economic regulators.

160.3 minimum flow or pressure rates (this also potentially interacts with the duty under section 25 of the Water Services Act to provide sufficient quality of drinking water).

161. If a service quality code is to be provided for, we recommend that legislation be clear as to when such a code may or must be introduced. We consider that the process and considerations for introducing a code should be streamlined relative to that provided for in Part 7 of the Telecommunications Act.[13]

Q23: What are your views on whether the consumer protection regulator should also be empowered to issue guidance alongside a code?

162. The Commission strongly supports the consumer protection regulator being empowered to issue guidance alongside a code. Providing guidance is a critical component of a regulatory regime. It can help to improve compliance by regulated parties with their obligations under legislation, and increase stakeholder understanding of a regulatory regime.

163. For the avoidance of doubt, we recommend that the regulator's ability to issue guidance be specified in legislation (as it is for the Commission under section 6 of the Fair Trading Act, section 25 of the Commerce Act, and section 111 of the Credit Contracts and Consumer Finance Act 2003).

Q24: What are your views on whether it is preferable to have provisions that regulate water service quality (not regulated by Taumata Arowai) in a single piece of economic regulation and consumer protection legislation?

164. The Commission agrees that it would be generally preferrable for the economic regulation and consumer protection provisions (excluding Taumata Arowai functions) to be included in a single piece of legislation. As discussed above in response to question 11, we consider that this should be standalone legislation, rather than an addition to the Commerce Act (or other existing legislation).

165. As the discussion paper suggests, inclusion of both economic regulation and consumer protection provisions in the same legislation may aid with navigation and understanding of the relevant regulatory regimes. However, more importantly, it may aid in the integration of the economic regulation and consumer protection regulatory regimes. As discussed above, we consider that there is potential for overlap between the tools provided for in a quality path under economic regulation and those that may be made use of in a service quality code. Inclusion of both

[13] Under the model for retail service quality codes under the Telecommunications Act, the Commission may provide guidance to the telecommunications industry on any matters relating to retail service quality codes, and review an industry-made code. The Commission may make a retail service quality code only if no industry-made retail service quality code exists, if the industry code fails to improve retail service quality, or if the Commission considers a Commission-made code would better improve retail service quality.

regimes in the same legislation may aid in delineating these functions at the legislation development phase.

Q25: What are your views on whether minimum service level requirements should be able to vary across different types of consumers?

166. The Commission supports an ability for minimum service level requirements to be able to vary across different types of consumers, for the reasons specified in the discussion paper.

Q26: What are your views on whether the regulatory regime should include a positive obligation to protect vulnerable consumers, and that minimum service level requirements are flexible enough to accommodate a wide range of approaches to protecting vulnerable consumers?

167. The Commission is neutral as to whether the regulatory regime should include a positive obligation to protect vulnerable consumers. If the Commission were the consumer protection regulator for water, we would likely seek to ascertain and understand the needs of different consumers (including vulnerable consumers), and ensure we took due account of those needs in administering a code, regardless of whether we were subject to a specific obligation to protect vulnerable consumers.

168. If an obligation to protect vulnerable consumers is imposed, the Commission considers that it would be more appropriate for this obligation to be imposed via a code, rather than as a direct statutory obligation on suppliers under primary legislation. This is because imposing a direct obligation through primary legislation, while also requiring the introduction of a code, could complicate the development of a code, in the event of overlaps. In addition, a code would likely be more flexible and adaptable than a direct obligation.

169. Based on our experience developing the 111 Contact Code under the Telecommunications Act, we also recommend that – if a statutory obligation to protect vulnerable consumers is imposed – 'vulnerability' should be defined in the legislation. We consider that paragraph 180 of the discussion paper onwards provides a good basis for such a definition. A statutory definition of vulnerability would allow the regulator to focus on the obligations under the code (in relation to both vulnerable and non-vulnerable consumers), rather than spending time determining an appropriate definition of vulnerability.

Q27: What are your views on how Treaty of Waitangi principles, as well as the rights and interests of iwi/Māori, should be factored into the design of a consumer protection regime for the three waters sector?

170. Our response to this question is addressed in the body of our submission.

Q28A: Do you consider that the consumer protection regime should apply to should apply to all water suppliers, water suppliers above a given number of customers, or just water service entities? Could this question be left to the regulator?

171. The Commission is not currently in possession of sufficient information to inform a view as to whether the benefits of any consumer protection regime are likely to exceed the costs if extended beyond the four WSEs. In the absence of such information upfront, we consider that an appropriate starting position would be for

the consumer protection regime – and any code in particular – to apply to entities subject to the economic regulation regime.

172. However, we can also envisage situations in which it may be appropriate for a code to apply more widely than the economic regulation regime, particularly given the potential for there to be lower costs in both applying and complying with a code relative to economic regulation. We note that retail service quality codes under the Telecommunications Act can apply to any telecommunications retail service provider. As such, we recommend an ability for the regulator to extend (or reduce) the application of the consumer protection regime, subject to an assessment of the likely costs and benefits of doing so.

Q28B: Do you support any other options to manage the regulatory impost on community and private schemes?

173. If the consumer protection regime were to be extended to community and private schemes, the Commission would support an appropriate transition period prior to the regime coming into effect. This date of commencement could either be specified in legislation or delegated to the regulator.

174. The Commission also supports the consumer protection regulator having the ability to differentiate the requirements that apply to different suppliers, so that reduced requirements could be applied to smaller suppliers, should they be included within the scope of consumer protection regime.

Q29: Do you broadly agree that with the compliance and enforcement tools proposed above? Are any additional tools required?

175. The Commission broadly supports the compliance and enforcement tools proposed for any consumer protection regime for water. We envisage that non-compliance with any elements of a consumer protection regime – such as a Code – would be treated similarly to non-compliance with elements of the economic regulation regime. Given this, for reasons of simplicity, and given the potential for overlap between the economic regulation and consumer protection regimes, we consider that the compliance and enforcement regime for consumer protection should be as close to the regime for economic regulation as possible (see our response to question 16 above).

176. We note that there is potential for crossover between the matters for which the consumer protection regulator may seek to take enforcement action, and the matters which could be covered under a water sector dispute resolution scheme (see Questions 34-39 below). We consider this to be workable. If the Commission were to be the consumer protection regulator, we envisage that the Commission would prioritise enforcement action in respect of systemic non-compliance. We would not be able to take enforcement action in respect of every complaint we received. A dispute resolution scheme would be a more appropriate avenue for consumers to resolve disputes or complaints in a timely manner. However, it would be important for there to be clear information available to consumers about where to go to

resolve their disputes, so that there would not be an expectation on the consumer protection regulator to address individual issues.

177. We note that the discussion paper refers to infringement offences, but does not explicitly include these in the table of potential compliance and enforcement tools for the consumer protection regime. The Commission recommends that consideration be given to be including infringement notices as one of the tools for the consumer protection regulator. We consider that infringement offences and associated notices could be an appropriate response to clear-cut breaches of a service quality code, such as a failure to disclose certain information to consumers (as distinct from failure to comply with information disclosure requirements under an economic regulation regime).

Q30: Do you agree with our preliminary view that the Commerce Commission is the most suitable body to be the consumer protection regulator for the three waters sector?

178. Our response to this question is addressed in the body of our submission.

Q31: What are your views on whether the regulator should be able to incentivise high-quality consumer engagement?

179. Similar to our response to question 13C, the Commission supports the regulator having the *ability* to incentivise high-quality consumer engagement, but does not support the regulator being *required* to incentivise high-quality consumer engagement.

180. As with active efficiency challenges, given the proposed form of WSEs, requiring the regulator to penalise regulated entities financially if they do not engage with consumers in a high-quality manner could, in effect, amount to imposing a penalty on consumers themselves. Similarly, in respect of non-financial incentives such as fast-track investment approvals, requiring a fast-track process for high-quality consumer engagement could have unintended effects such as requiring the regulator to 'cut corners' in its approval role.

181. Despite this, the Commission nevertheless supports the regulator to have flexibility to incentivise high-quality consumer engagement, such as in situations when there would not be such unintended consequences.

182. In addition to *incentivising* high-quality engagement, it would also be useful for the regulator to be able to *specify* the nature of engagement that regulated entities undertake. Under Part 4 of the Commerce Act, the Commission can specify the disclosure of information, including the mechanism of disclosure, under information disclosure regulation. In relation to customised price paths (CPPs), we can also specify some form of consultation with consumers during the development of a CPP proposal (see section 52T of the Commerce Act). However, the Commission cannot require consultation outside of the CPP development process or specify more intensive forms of engagement with consumers. This is one of the matters that could be covered by performance requirements (see the body of our submission).

Q32: What are your views on whether there is a need to create an expert advocacy body that can advocate technical issues on behalf of consumers?

183. The Commission supports the establishment of an expert advocacy body for three waters services. In respect of the economic regulation functions we currently undertake under the Commerce Act and Telecommunications Act, our role is to promote the long-term benefit of consumers, as specified in the purpose of this legislation. However, this is not the same as 'advocating' for consumers.

184. As part of our existing economic regulation processes, consumers and consumer groups have an opportunity to engage in the consultation and other engagement processes we undertake. We have found that our processes are improved when appropriately resourced participants with a consumer perspective can provide considered and well-informed input into our work. This is particularly the case where our decisions relate to highly technical matters, such as the methodologies for determining regulated suppliers' cost of capital, or for valuing the assets used to supply regulated services.

185. However, as the discussion paper notes, it can be difficult for consumers and consumer advocates to engage on matters of technical detail. In terms of our existing regulatory functions, examples of well-resourced consumers and/or consumer groups that engage with our processes include the Major Electricity Users' Group in respect of electricity, Internet NZ and TUANZ in respect of telecommunications, and airlines in respect of airports.

186. In the absence of a statutory expert advocacy body, it is not immediately clear which consumers or groups (if anyone) would be adequately resourced or motivated to advocate effectively on behalf of consumers. As such, a well-resourced consumer advocacy body could help ensure that the regulator is provided with a well-researched, evidence-based consumer view, to balance to industry views.

Q33: What are your views on whether the expert body should be established via an extension to the scope of the Consumer Advisory Council's jurisdiction?

187. We do not have a position on the institutional structure for any consumer advocacy body.

Q34: What are your views on whether there is a need for a dedicated three waters consumer disputes resolution scheme?

188. The Commission supports consumers having a clear path to resolve disputes relating to three waters services, and considers that a dedicated three waters consumer dispute scheme may assist with this. As discussed above, if the Commission were to be the economic and/or consumer protection regulator, we would not be able to take enforcement action or seek resolution for consumers in respect of every complaint we received.

189. If the Commission were to be the economic and/or consumer protection regulator for three waters, we would not support the extension of the model provided for in

section 39 of the Water Services Act[14] to any matters overseen by the Commission. This is because, given the breadth of the Commission's other responsibilities, it may be more approriate for this function to be undertaken by a separate body.

190. We also consider it critical for there to be clear information available to consumers about where to go to resolve their disputes, so that the regulator would not be expected to address individual issues. Our experience with telecommunications is that the existence of multiple sector dispute resolution schemes can create complexity and confusion.

191. The potential for crossover between a dedicated three waters disputes resolution scheme and the disputes resolutions processes under the Water Services Act is addressed in the body of the Commission's submission.

Q35: What are your views on whether these kinds of disputes should be subject to a dispute resolution schemes? Are there any other kinds of issues that a consumer dispute resolution provider should be able to adjudicate on?

192. The Commission supports the matters set in paragraph 228 of the discussion paper being within the remit of any three waters consumer dispute resolution scheme.

193. We consider it likely that the regulator will receive a range of complaints that will be better addressed by a dispute resolution provider. As such, we consider that the dispute resolution provider should be able to consider any complaints referred to it by relevant regulators, not just those relating to the conduct of the water service provider.

194. We agree that a dispute resolution scheme should not be able to consider complaints about price-quality paths imposed by the economic regulator. It may also be beneficial to specify that complaints may not relate to the overall level or structure of prices set within such a price-quality path (but could consider instances of overcharging within this framework), to ensure that there was no inadvertent secondary impact on any price-quality paths.

Q36: What are your views on whether a mandatory statutory consumer disputes resolution scheme should be established for the water sector?

195. Our recent experience reviewing the experience Telecommunications Dispute Resolution Scheme suggests that there are benefits associated with wide membership of a dispute resolution scheme.[15] In the context of water, mandatory

[14] Under which a drinking water consumer who is not satisfied with the outcome of a complaint may request Taumata Arowai to review the complaint, and Taumata Arowai must:

- investigate the drinking water supplier's handling of the complaint; and
- take any action that Taumata Arowai considers necessary as a result of its investigation findings.

[15] Commerce Commission. (2021). *2021 Review of the Telecommunications Dispute Resolution Scheme: Report to the New Zealand Telecommunications Forum Inc. (TCF) on recommendations for improvements to the TDRS.* Retrieved from: https://comcom.govt.nz/__data/assets/pdf_file/0020/270083/Report-to-the-New-Zealand-Telecommuncations-Forum-on-recommendations-for-improvements-to-the-TDRS-11-November-2021.pdf

membership of any dedicated three waters dispute resolution scheme may be an effective way to achieve this.

Q37: Do you consider that a new mandatory statutory consumer disputes resolution scheme should be achieve via a new scheme or expanding the jurisdiction of an existing scheme or schemes?

196. We do not have a position on whether any new mandatory statutory consumer disputes resolution scheme should be achieved via a new scheme or expanding the jurisdiction of an existing scheme or schemes.

Q38: Do you consider that the consumer disputes resolution schemes should apply to all water suppliers, water suppliers with 500 or more customers, or just water service entities?

197. We do not have a position on which suppliers a new mandatory statutory consumer disputes resolution scheme should apply to. However, it may be pragmatic for this to be aligned with the coverage of any service quality code.

Q39: Do you think the consumer dispute resolution scheme should incentivise water suppliers to resolve complaints directly with consumers?

198. The Commission supports measures to incentivise suppliers to resolve disputes with consumers directly, including the use of charging suppliers for investigation of complaints.

Q40: Do you consider that there should be special considerations for traditionally under-served or vulnerable communities? If so, how do you think these should be given effect?

199. The Commission supports measures to support traditionally under-served or vulnerable consumers to access dispute resolution services, and considers that paragraph 238 of the discussion paper sets out a number of good-practice approaches.

Q41: What are your views on whether the costs of implementing a consumer protection regime for the three waters sector should be funded via levies on regulated suppliers?

200. Please refer to our answer to question 18 above.

Q42: Do you think that the levy regime should:

A) Require the regulator to consult on and collect levy funding within the total amount determined by the Minister? OR

B) Require the Ministry to consult on the levy (on behalf of the Minister) and collect levy funding within the total amount determined by the Minister?

Q43: Are there any other levy design features that should be considered?

201. Please refer to our answer to questions 19 and 20 above.

Q44: Do you consider that *regulatory charters* and a *council of water regulators* arrangements will provide effective system governance? Are there other initiatives or arrangements that you consider are required?

202. The Commission is generally supportive of measures to improve regulatory coordination and system governance, including the proposed regulatory charters and a council of water regulators.

Q45: Do you consider it is useful and appropriate for the Government to be able to transmit its policies to the economic and consumer protection regulator(s) for them to have regard to?

203. The Commission supports the government being able to transmit its policies to the economic and consumer protection regulator(s), in a manner akin to that provided for under section 26 of the Commerce Act. We consider that such a mechanism strikes an appropriate balance between regulatory independence and responsiveness to the political context in which crown entities such as the Commerce Commission operate.

204. The body of our submission addresses broader questions about the Government Policy Statement and Statement of Strategic and Performance Expectations that will be directed towards WSEs, and their interaction with an economic regulation regime.

Q46: What are your views on whether the economic and consumer protection regulator should be able to share information with other regulatory agencies? Are there any restrictions that should apply to the type of information that could be shared, or the agencies that information could be shared with?

205. The Commission strongly supports the economic and consumer protection regulator(s) for three waters having the ability to share information with other regulatory agencies. Given the potential for overlap between Taumata Arowai and the economic and consumer protection regulator(s), information sharing will be important to improve regulatory coordination and the coherence of the regulatory system, and to reduce the compliance burden on regulated entities.

206. We note that the Commerce Amendment Bill currently before Parliament will formalise the ability of the Commission to provide share information with other regulators or government departments that the Commission:

206.1 holds in relation to the Commission's functions, powers, or duties under the Commerce Act or any other legislation; and

206.2 considers may assist the regulator or government department in the performance or exercise of its functions, powers, or duties under legislation.

207. Similarly, the Commerce Amendment Bill provides that the Commission may use any information, or a copy of any document, in the Commission's performance or exercise of its functions, powers, or duties under any legislation if the information or copy is provided to the Commission by a regulator or government department.

208. We consider that the safeguards provided for in the Commerce Amendment Bill, including that the Commission must be satisfied that appropriate protections are in place for the information, and that the Commission may impose conditions on the provision of information or documents, are appropriate.