



## COVERSHEET

<b>Minister</b>	Hon Dr David Clark	<b>Portfolio</b>	Commerce and Consumer Affairs
<b>Title of briefing</b>	Economic Regulation and Consumer Protection in the Three Waters Sector	<b>Date to be published</b>	8 December 2022

<b>List of documents that have been proactively released</b>		
<b>Date</b>	<b>Title</b>	<b>Author</b>
June 2022	Economic Regulation and Consumer Protection in the Three Waters Sector	Office of the Minister of Commerce and Consumer Affairs
7 June 2022	Economic Regulation and Consumer Protection in the Three Waters Sector CAB-22-MIN-0207 Minute	Cabinet office
June 2022	Regulatory Impact Statement: Economic Regulation and Consumer Protection in the Three Waters Sector	MBIE

### **Information redacted**

**YES**

Any information redacted in this document is redacted in accordance with MBIE's and MFAT's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld for the reason of Confidential advice to Government.



# Cabinet

## Minute of Decision

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### Economic Regulation and Consumer Protection in the Three Waters Sector

**Portfolio**                      **Commerce and Consumer Affairs**

On 7 June 2022, following reference from the Cabinet Economic Development Committee, Cabinet:

#### Background

- 1        **noted** that during 2021 and early 2022, Cabinet made a series of decisions to transform the three waters service delivery system, and noted that an economic regulation and consumer protection regime would help the four new water services entities to realise efficiencies [CAB-21-MIN-0226-0228, CAB-21-MIN-0269, CAB-21-MIN-0419, CAB-22-MIN-0144];
- 2        **noted** that the Minister of Local Government is leading the Three Waters Reform, but that economic regulation and consumer protection falls within the Commerce and Consumer Affairs portfolio;

#### Part A: Economic regulation regime

- 3        **agreed** to create an economic regulation regime for three waters;

#### Purpose of economic regulation regime

- 4        **agreed** that:
  - 4.1      the purpose of economic regulation will be based on the purpose statement set out in Part 4 of the Commerce Act 1986, i.e. promoting the long-term benefit of water consumers by promoting outcomes that are consistent with outcomes produced in competitive markets; but
  - 4.2      this purpose may need to be adapted to recognise the unique characteristics of the water sector, including the fact that entities are prohibited from paying dividends;

#### Te Tiriti, Te Mana o te Wai obligations

- 5        **agreed** that the economic regulator and the Minister of Commerce and Consumer Affairs be required to take into account the entities' obligations in respect of Te Tiriti o Waitangi, Te Mana o te Wai, and Treaty settlements, to ensure the relevant costs and processes are reflective of these obligations;

- 6 **agreed** that the economic regulator be required to develop and maintain systems and processes to ensure it has the capability to uphold Te Tiriti o Waitangi, and to engage with and to understand perspectives of Māori;

#### Climate change considerations

- 7 **agreed** that the economic regulator and the Minister of Commerce and Consumer Affairs be required to take into account the entities' obligations in relation to climate change;

#### Scope of economic regulation

- 8 **agreed** that the legislation initially apply to all four entities, as specified by the legislation, but that the Minister of Commerce and Consumer Affairs have the power to exempt or designate certain suppliers via Order in Council on the recommendation of the regulator;
- 9 **agreed** that the legislation apply to the drinking water, wastewater, and stormwater services of the entities;

#### Form of regulation

- 10 **agreed** that information disclosure regulation should always apply to regulated suppliers;
- 11 **agreed** that legislation set out that input methodologies and price-quality regulation determinations are subject to merits reviews by the High Court;
- 12 **agreed** that legislation require the economic regulator to make price-quality and quality-only regulation determinations applying to the entities, and that these include quality standards and performance requirements;
- 13 **agreed** that the economic regulator be able to make individual price-quality regulation determinations;
- 14 **agreed** that the economic regulator be required to set input methodologies;
- 15 **agreed** that the economic regulator be able to set comparative efficiency benchmarks in price-quality and quality-only regulation determinations;
- 16 **agreed** that in making price-quality regulation determinations, the economic regulator be able to:
- 16.1 'ring-fence' a portion of entities' allowable return, in case of unexpected investment requirements;
  - 16.2 smooth maximum revenue over multiple periods to mitigate average price shocks;
  - 16.3 allow for a wash-up mechanism for revenue over- or under-recovery;
- 17 **noted** that the economic regulator will have responsibilities in relation to pricing principles and rules, as set out in the associated paper, *Three Waters Services: Pricing and Charging*, under CAB-22-SUB-0206;

#### Implementation of economic regulation

- 18 **agreed** that the economic regulator have the discretion to choose the length of regulatory periods beyond the first regulatory period, but that they be no longer than six years, and that the first regulatory period be three years;

- 19 **noted** that there will be a pre-regulatory period (2023-2026) in which the economic regulator will work with the water sector to build its understanding of how to comply with economic regulation, before determining the rules required for the first regulatory period;
- 20 **agreed** that quality-only regulation should apply alongside information disclosure regulation in the first regulatory period;
- 21 **agreed** that:
- 21.1 the economic regulator develop input methodologies and basic information disclosure requirements between 2024 and 2026, and develop full information disclosure regulation and quality-only regulation between 2026 and 2027;
- 21.2 the first regulatory period run from 2027 to 2030;
- 22 **authorised** the Minister of Commerce and Consumer Affairs to change these implementation dates;
- 23 **agreed** that the legislation allow for different approaches to regulating different entities (e.g. Entity A) and services (e.g. stormwater);
- 24 **directed** the Ministry of Business, Innovation and Employment and the Department of Internal Affairs to report back to the Ministers of Local Government and Commerce and Consumer Affairs by 31 August 2022 on options (particularly non-statutory options) for accelerating benefits to consumers from additional scrutiny of Watercare in the transition period, including on a fast-tracked approach to implementing price-quality regulation for Entity A and how much this would cost;
- 25 **agreed** that on 1 July 2030 (i.e. seven years after enactment), the economic regulator be required to implement price-quality regulation, unless the Minister of Commerce and Consumer Affairs considers certain criteria have been met, including the best long-term interests of consumers, following a recommendation from the economic regulator, and recommends an Order in Council to change this requirement;
- 26 **agreed** that the economic regulator be able to conduct reviews and make recommendations to the Minister of Commerce and Consumer Affairs regarding the scope or form of regulation;

#### **Compliance and enforcement tools**

- 27 **agreed** that the economic regulator have a range of compliance and enforcement tools for breaches of regulatory requirements (as set out in determinations), adapted from the Commerce Act 1986 and Telecommunications Act 2001, including incentives, offences, enforceable undertakings, pecuniary penalties (maximum \$500,000 for an individual and \$5 million for a body corporate), compliance orders, compensation, injunctions, and educational activities;
- 28 **noted** that the economic regulator may rely on reputational incentives, rather than financial incentives, in driving compliance;
- 29 **noted** that the economic regulator will be able to issue guidance on its functions and powers under the new regime;

- 30 **agreed** that the economic regulator have powers to monitor the wider three waters system in order to assess whether it is operating efficiently and delivering good outcomes for consumers, including investigative powers based on those set out in the Commerce Act 1986;

#### **Legislative vehicle for the regime**

- 31 **agreed** to introduce a new, sector-specific economic and consumer protection legislative regime for three waters;

#### **Part B: Consumer protection regime**

- 32 **agreed** to create a consumer protection regime for three waters;

#### **Purpose of consumer protection regime**

- 33 **agreed** that the purpose of the new consumer protection regime be to improve service quality to reflect the demands of three waters consumers;

#### **Scope of consumer protection**

- 34 **agreed** that the consumer protection regime initially apply to all four entities, as specified by the legislation, but that the Minister of Commerce and Consumer Affairs have the power to exempt or designate certain suppliers via Order in Council on the recommendation of the regulator;

#### **Minimum service level codes**

- 35 **agreed** that the consumer protection regulator be required to set a minimum service level code via determination;
- 36 **agreed** that in setting minimum service levels, the consumer protection regulator be required to consider the interests of vulnerable consumers;
- 37 **agreed** that the consumer protection regulator have a range of compliance and enforcement tools at its disposal for breaches of minimum service levels code determinations, adapted from remedies available under the Fair Trading Act 1986 and Telecommunications Act 2001, including educational outreach activities, warning letters, infringement notices, enforceable undertakings, reputational incentives, pecuniary penalties (maximum \$500,000 for an individual and \$5 million for a body corporate), compensation, compliance orders and injunctions;
- 38 **noted** that the minimum service level code will complement the customer agreement requirements proposed by the Minister of Local Government;

#### **Strengthening the consumer voice**

- 39 **agreed** that the consumer protection regulator be required to incentivise entities to engage with consumers, including vulnerable consumers;
- 40 **agreed** that an expert body be established to advocate on behalf of three waters consumers on technical issues by extending the mandate of the Consumer Advocacy Council;

#### **Consumer disputes resolution**

- 41 **noted** that sections 38-40 of the Water Services Act 2021 provide for all consumers to complain to Taumata Arowai about drinking water issues;

- 42 **agreed** to establish a consumer disputes resolution framework for consumers of the services provided by the four waters services entities;
- 43 **authorised** the Ministers of Local Government, and Commerce and Consumer Affairs to make further decisions on the most appropriate structure of consumer dispute resolution schemes in the water services sector, with the following objectives:
- 43.1 ensuring that all drinking water consumers, and all consumers of wastewater and stormwater services provided by the water services entities have access to appropriate dispute resolution services;
  - 43.2 ensuring that Taumata Arowai obtains necessary and timely information on drinking water quality issues;
  - 43.3 consumers easily understand where to direct complaints;
- 44 **noted** that the above proposals may require amendment or repeal of sections 38-40 of the Water Services Act 2021;
- 45 **agreed** that the Minister of Commerce and Consumer Affairs be able to appoint an existing independent disputes resolution provider to administer a consumer dispute resolution scheme;
- 46 **agreed** that it be compulsory for the four new entities to belong to the consumer dispute resolution scheme, and voluntary for other suppliers;
- 47 **agreed** that legislation set out the consumer disputes resolution framework, adapted from sections 38-40 of the Water Services Act 2021 and Part 7 of the Telecommunications Act 2001;

### **Part C: Agency responsibility for the new regime**

- 48 **agreed** that the Commerce Commission be the agency responsible for economic regulation and consumer protection in the three waters sector;
- 49 **agreed** to create a position of Water Commissioner or similar on the Commerce Commission's board;
- 50 **noted** that the Minister of Commerce and Consumer Affairs has instructed officials to work with the Commerce Commission on how these governance arrangements could be designed, and will report back to Cabinet if necessary;
- 51 **noted** that the Commerce Commission will be able to share information with Taumata Arowai, and vice versa;

### **Legislative implications**

- 52 **noted** that the above proposals will be given effect by the Water Regulation Bill, or by the Water Services Entities Amendment Bill;
- 53 **agreed** that the legislation commence in mid-late 2023;
- 54 **authorised** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs;

55 **authorised** the Minister of Commerce and Consumer Affairs to make minor or technical changes to the above proposals, as well as additional policy decisions, consistent with the general policy intent, on issues that arise in drafting and passage through the House;

### Financial implications

56 **noted** that implementing economic regulation for three waters comes with the following estimated costs:

56.1 developing the rules and processes underpinning the application of economic regulation is likely to cost around \$10 million over two years;

56.2 costs of roughly \$5 million per annum on average for information disclosure, \$3 million per annum average for price-quality regulation, and \$2 million on average for quality-only regulation;

56.3 costs of a minimum service code of around \$2 million in the first year and \$1.5 million per annum in subsequent years;

57 **noted** that the costs involved in developing and operating a consumer disputes resolution scheme would likely be met by the scheme's members, and that comparable schemes in other sectors cost around \$2 to \$3 million annually;

58 **noted** that Cabinet has previously authorised the Minister of Local Government, the Minister of Finance and any other relevant appropriation Minister(s), to jointly draw down funding from the *Transforming Three Waters Service Delivery for New Zealanders: Transition and Implementation* tagged contingency up to a maximum of \$4 million to meet the costs associated with the work to support the transition to economic regulation, once they are satisfied that the relevant stage of the work programme has been sufficiently developed with detailed timeframes, milestones and costs [CAB-21-MIN-0419];

59 **noted** that the Minister of Commerce and Consumer Affairs will work with officials to determine the appropriate funding arrangements for this work, including funding for:

59.1 preparatory work required during the pre-regulatory period, including engagement with Watercare;

59.2 the economic regulator's obligations relating to pricing and charging;

59.3 a possible extension of the remit of the Consumer Advocacy Council;

60 **authorised** the Minister of Commerce and Consumer Affairs to recommend levy regulations be made by Order in Council in order to levy regulated suppliers to fund the activities of the economic regulator and the consumer protection regulator, including input methodologies, information disclosure regulation, quality-only regulation, price-quality regulation and a minimum service level code, and that this be a Ministry-led levy process.

Michael Webster  
Secretary of the Cabinet