



COVERSHEET

Minister	Hon Andrew Bayly	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	New appropriation and proposed discussion document for levy recovery of the Commerce Commission costs for water services regulation	Date to be published	4 December 2024

List of documents that have been proactively released		
Date	Title	Author
November 2024	New Appropriation and Proposed Discussion Document for Levy Recovery of the Commerce Commission Costs for Water Services Regulation	Office of the Minister for Commerce and Consumer Affairs
19 November 2024	New Appropriation and Proposed Discussion Document for Levy Recovery of the Commerce Commission Costs for Water Services Regulation EXP-24-MIN-0068 Minute	Cabinet Office
21 November 2024	Interim Stage 2 Cost Recovery Impact Statement – Commerce Commission Funding for Water Services Regulation	MBIE

Information redacted

YES / NO *(please select)*

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Some information has been withheld for the reasons of commercial information and constitutional conventions.

Interim Stage 2 Cost Recovery Impact Statement

Commerce Commission Funding for Water Services Regulation

Agency Disclosure Statement

This Interim Cost Recovery Impact Statement (CRIS) has been prepared by the Ministry of Business Innovation and Employment (MBIE).

It provides an analysis of options to recover the costs of funding the Commerce Commission's (the Commission's) regulation of local government water service providers. This interim CRIS is included with proposals for a levy for consultation and will be finalised to take account of submissions on the proposals.

The estimates of costs are sensitive to the number of regulated suppliers. There are currently 67 local government water service providers, but as a result of Local Water Done Well it is expected that a number of local authorities will decide to change how they deliver water services. For example, some local authorities will likely amalgamate delivery through new council-controlled organisations owned by multiple councils or community owned trusts. The Commission has assumed that the number of water service providers to be regulated will decrease and that it will regulate 50 water service providers.

Because councils have never been exposed to economic regulation in the delivery of water services, there is a lack of information on council provided council services and uncertainty regarding the future shape of the industry. In addition, the Commission is still building experience on council water service providers, adding to the uncertainty. The Commission will focus on deploying information disclosure regulation over the initial five-year period which will build transparency and inform its application of other regulatory tools (eg price quality regulation) over a longer time.

It has been assumed that during the first five years of regulation only Watercare will be exposed to price quality regulation, and that all other providers will only be subject to information disclosure requirements. The earlier application of price quality regulation and other regulatory tools would increase the Commission's costs, subject to Cabinet approval to increase the appropriation.

This CRIS has been prepared with limited and variable information on the number of households connected to council water service providers. This is because many councils do not directly charge for water services and there is no consistent information at a national level on the number of households connected to council water services.

There has been no consultation with councils or other affected persons on the proposals contained in this Interim CRIS. The intention is that proposals will be consulted on by MBIE, that this Interim CRIS will accompany the proposals to be consulted on, and that this Interim CRIS will be finalised following consultation.

Catherine Montague

Manager Competition Policy

21/11/2024

Executive summary

- Following the enactment of the Local Government (Water Services) Bill (**the Bill**), the Commission will have a range of tools under the Commerce Act 1986 to promote sufficient revenue recovery, and efficient investment and maintenance, so that local government water services meet regulatory requirements and are delivered at a quality that communities expect.
- The Commission will need to be resourced to carry out these new functions. A levy to fully recover the costs of the Commission's new functions from 1 July 2025 onwards is proposed, excluding litigation and Crown Monitor costs for Watercare. This proposed levy model is used to recover the Commission's costs, not to directly fund the Commission, and is fiscally neutral for the Crown.
- This proposed approach of 100 percent levy recovery is consistent with other regulated services under Part 4 of the Commerce Act 1986 (for example, electricity lines and gas pipeline services), and supports the principle that regulated suppliers that drive the need for the Commission's functions and should bear the costs.
- It is further proposed that the levy should specify a method for calculating the levies and providing for different levies for classes of suppliers or services. Costs would be allocated in proportion to the normally residing population served by each regulated supplier, based on the latest census data.
- The Commission would have incentives to operate efficiently and effectively within the appropriation over the appropriation period, and it returns any unspent funds to the Crown. The levy wash-up process ensures the regulated suppliers only pay the Commission's actual costs. It is proposed that the arrangements be reviewed in 2027/28, unless issues are identified earlier.

Status quo

Local Water Done Well sets out a direction for financially sustainable water services, underpinned by a robust regulatory system. It puts an emphasis on meeting regulatory standards, and the transparent and financially sustainable performance of local water services – but provides for local choice about the form of service delivery structures.

The current water services regulatory system has gaps and weaknesses. These shortcomings, when combined with other factors, have contributed to decades of underinvestment in water services infrastructure – stifling growth and contributing to the chronic infrastructure deficit this country is facing.¹

The regulatory system currently includes:

- drinking water quality regulation and standards – regulated by the Water Services Authority- Taumata Arowai (**the Authority**); and
- environmental regulation – regulated by regional councils, with a national oversight role by the Authority in respect of the environmental performance of drinking water, wastewater and stormwater networks.

¹ For further information on the policy problem that the reforms are addressing, see here Regulatory Impact Statement: Local Government Water Services Bill: <https://www.treasury.govt.nz/sites/default/files/2024-08/ris-diambie-lgwts-jun24.pdf>

There is a significant gap regarding economic regulation of water services. Councils currently face few requirements relating to the management of water infrastructure, and none for infrastructure investment. Those requirements that are in place – such as the transparency and accountability provisions in the Local Government Act 2002 (**LGA02**) – have failed to result in adequate levels of investment, or charges that reflect the costs of providing water services. While council long-term plans, infrastructure and financial strategies are reviewed by auditors, they are not reviewed by an economic regulator – and there are no independent experts overseeing the levels of investment.

To address this weakness, Cabinet has agreed that economic regulation is needed to safeguard the interests of consumers in local water services. Cabinet has agreed to an economic regulation framework for council water services providers similar to Part 4 of the Commerce Act 1986 to come into force mid-2025 [ECO-24-MIN-0107]. This is to provide incentives and regulatory oversight to increase investment in and improve the financial performance of council water services.

The Local Government Water Services Bill (**Bill 3**) when enacted by mid-2025 will provide for a comprehensive, flexible, and risk-based approach to regulation tailored to the characteristics of local water services. Features of the regime include the Commission being able to tailor regulatory requirements based on the water service provider and type of service [ECO-24-MIN-0107].

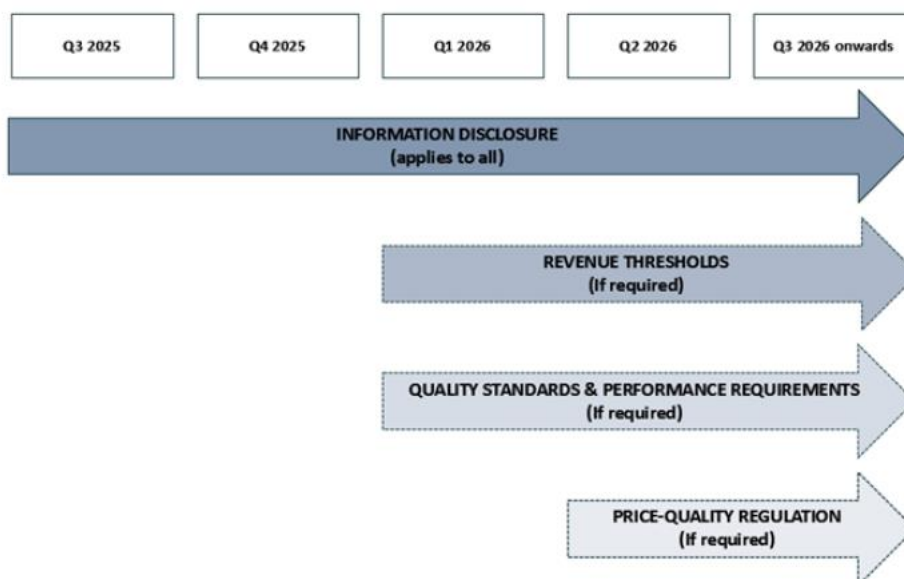
Bill 3 is intended to provide the Commission with an appropriate and flexible set of regulatory tools, backed by enforcement provisions similar to those provided for in Part 4 of the Commerce Act. The main regulatory tools are:

- information disclosure
- the setting of maximum and minimum revenue thresholds
- quality regulation
- performance requirements, and
- price-quality regulation.

Information disclosure will be the first tool to come into effect. It will provide the means for the Commission to promote transparency regarding the performance of council water service providers. It will also help to inform when and how to apply other regulatory tools to improve the performance of individual water service providers. The application of these tools will be sensitive to the performance and characteristics of each water service provider and could include the Commission's setting of revenue thresholds, quality standards, specific performance requirements, and price quality regulation. The application of these tools will vary across water service providers.

It is anticipated that information disclosure requirements will be set by the Commission six months after the enactment of Bill 3.

The diagram below outlines when each of the proposed tools is expected to come into effect, starting with information disclosure provisions from the date of enactment of enabling legislation in late 2025.



Economic regulation is designed to put incentives on council water service providers to better deliver their water services. Councils will be free to decide how best to structure and organise the delivery of their water services. This includes through establishing organisations designed to operate independently of councils or through organisations owned by multiple councils or consumer trusts. As a result, there will likely be a variety of types of organisations providing local water services, and this mix of organisations will likely change and evolve over time.

Initially economic regulation will only apply to the delivery of drinking water and wastewater services, but there will be provision to extend its scope in the future to include stormwater services.

Legislation will provide authority to charge a levy

Cabinet agreed that Bill 3 will also provide for regulations to be made for levies to fund the Commission's costs of carrying out its functions and duties. It is intended that this will be through Order in Council, made on the recommendation of the Minister of Commerce and Consumer Affairs (**the Minister**). It is expected that the Bill will enable the levy making power (section 53ZE of the Commerce Act) to be applied to regulated water services suppliers.

Levy regulations may be made (or amended) on the recommendation of the Minister, after the Minister consults with the suppliers of regulated goods or services, or representatives of those suppliers (section 53ZE(4)).

It is expected that Bill 3 will provide transitional provisions to enable the water services economic regulation regime to be set up. This could include the ability to treat consultation on the discussion document accompanying this interim CRIS as sufficient for the purposes of meeting the requirement for the Minister to consult before recommending regulations be made setting levies on water services suppliers under section 53ZE(4).

It is expected that Bill 3 will also enable regulations to be made specifying the amount of levies, or method of calculating the amount of levies on the basis that the estimated costs for an appropriation period of performing the Commission's functions, powers, and duties, and of collecting the levy money, should be met fully out of levies.

If the levy regulations come into force after 1 July 2025, the levy making power includes provisions that allow for the recovery of the Commission's costs incurred before the regulations were made and/or before regulated suppliers became subject to Part 4 of the Commerce Act. These provisions will ensure the Commission's costs for the full 2025/26 financial year may be recovered (section 53ZE(2)(g) of the Commerce Act).

Stage 1 Cost Recovery Impact Assessment

Government decisions to legislate for a levy to recover the Commission's costs of regulating council water service providers were informed by a Stage 1 CRIS.² In this CRIS the option of levy versus Crown funding was assessed and levy funding was recommended. This Interim Stage 2 CRIS summarises the previous analysis and provides additional evaluation of options to implement levy funding under the provisions of the Commerce Act.

Cost Recovery Principles and Objectives

Principles

The overarching principles for cost recovery are that,

- the Commission will have independence in its economic regulation of council water service providers; and
- to the extent possible all of the Commission's costs in administering the economic regulation of council water service providers will be recovered from those that give rise to the need for economic regulation and benefit from it.

It is proposed that the funding arrangements for the Commission's regulation of water services will involve:

- A dedicated appropriation to fund the Commission to carry out its regulatory functions. This appropriation was informed by estimates and forecasts of the Commission's costs in establishing and administering economic regulation of water service providers. This will provide the Commission with certainty of funding while also keeping a cap on its expenditure through an appropriation as determined by Parliament.
- Administration of the appropriation by MBIE including monitoring the Commission's performance. Performance measures will be set to gauge the Commission's performance (e.g. outputs, timeliness, intended impacts). The Commission will be subject to normal accountability arrangements to Parliament relating to its activities under the appropriation (e.g. annual reporting).
- Recovery of the appropriation through a levy payable to the Minister and administered by MBIE. The levy will seek to apportion the Commission's costs for all regulatory activities or classes of regulatory activities to those regulated suppliers that drive the need for the regulated activity. This ensures that only those regulated suppliers subject to additional regulation (e.g. price quality regulation) will bear those costs.

² DIA, 12 June 2024, Annex 2 of the Regulatory Impact Statement: Local Government Water Services Bill, (available here: [https://www.dia.govt.nz/diawebsite.nsf/Files/Regulatory-Impact-2024/\\$file/RIS-Paper-2-12-June-2024-%20Local-Government-Water-Serivces-Bill.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Regulatory-Impact-2024/$file/RIS-Paper-2-12-June-2024-%20Local-Government-Water-Serivces-Bill.pdf))

Guiding objectives

The design and administration of the recommended levy funding option is informed by the following objectives:

- *Equity – levy charges should be distributed fairly and equitably among regulated water service suppliers, so that those who create the need for, or benefit from, the Commission’s economic regulation of water service providers bear the costs associated with its activities.* This is based on the principle that public organisations should administer and manage fees and levies in ways that are administratively fair and ensure that they do not seek to recover costs from one group that might benefit a previous or future group.
- *Efficiency – the approach to charging should*
 - *support the financially sustainable and efficient delivery of water services by encouraging compliance with regulatory requirements,*
 - *while also being simple and low cost to administer.*
- *Justifiability – the costs recovered through levy should reasonably relate to the regulatory services being charged for, and, where possible, cross-subsidisation should be eliminated.*
- *Transparency – the approach to setting and administering the levy should be open and understandable and support the accountability of the Commission to Parliament and the public for its funding and its regulation of water service providers. This requires transparent processes in place for setting and managing fees and levies. It is about providing enough information to fee and levy payers so they can understand and assess charges.*

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

The Stage 1 CRIS assessed funding options including full Crown funding, fees and levy funding.³ It concluded that cost recovery via a levy to be paid by regulated water service suppliers, as provided for in the Commerce Act, is the most appropriate option for the recovery of the Commission’s costs in regulating water services.

Cost recovery is appropriate for the economic regulation of council water services

Recovery of the Commission’s costs in regulating water services from water service suppliers, rather than direct Crown funding, is appropriate because:

- Water service suppliers have given rise to the need for economic regulation of their locally provided water services. This is because councils have underinvested in their water services and have generally undercharged households and business for the water services they provide.

³ Refer footnote 1.

- The benefits of economic regulation will be realised by water service suppliers, their ratepayers and the local households and businesses that are connected to the water services they provide.
- Economic regulation will only apply to council water services. The Commission's outputs and activities will be confined to the regulation of council water service providers (regulated parties).

To be paid by regulated water service suppliers

The stage 1 CRIS recommended that the levy should be paid by regulated water service suppliers, on the basis that councils and their water service suppliers have given rise to the need for economic regulation because of their poor past financial performance, and that they will pass the costs of the levy on to their consumers who will benefit from the regulation.

This is consistent with the levy power under section 53ZE of the Commerce Act, which provides that every supplier of regulated goods or services (or prescribed class of suppliers of regulated goods or services) must pay to the Minister the levy determined in accordance with regulations made under the section.

We considered the option of a levy payable by the council of the regulated water service supplier (where those entities are different). However, this option was not feasible due to the requirements of section 53ZE that the supplier of regulated goods or services must pay the levy.

The level of the proposed levy and its cost components (cost recovery model)

The outputs to be funded by the proposed levy relate to the Commission's regulation of council water service suppliers

The Commission's activities are regulatory, and necessary to improve council water service suppliers' performance for the benefit of consumers. The Commission's core regulatory activities (common to all regulated water service suppliers) are:

- **Information disclosure:** the Commission will set requirements relating to when certain information must be collected and disclosed. All regulated suppliers will be required to disclose this information to improve transparency on performance. Information disclosure may also inform the need for any further regulatory intervention. The Commission's role under information disclosure also includes preparing and publishing reports on regulated suppliers' performance.
- **Revenue thresholds:** the Commission will be able to set revenue thresholds at their discretion, so that providers have a clear understanding about the level of revenue they need to collect and invest in water infrastructure.
- **Financial ringfencing:** the Commission will monitor and enforce the requirement that water services revenue is spent on water services alone.
- **Compliance monitoring and reporting:** the Commission will be required to monitor compliance with regulatory requirements and, where necessary, to take enforcement action.

It is also intended that legislation will, through regulations made on the recommendation of the Minister, provide for the following tools to regulate some but not necessarily all council water service suppliers. Their application to a regulated water service supplier will depend on the supplier's characteristics and performance as determined by the Commission through information disclosure. These tools include:

- **Performance requirements:** Requirements on water service suppliers to perform certain actions to improve network service quality. For example, to make types of investments in their water services infrastructure.
- **Quality only regulation:** Quality standards or quality incentives to improve services.
- **Price-quality regulation:** Setting minimum and/or maximum prices that may be charged by a water service supplier, and/or minimum and/or maximum revenues.
- **Consumer protection:** Legislation will provide for regulations to be made that the Commission will administer to address any issues that are identified in relation to how consumers are being treated by regulated suppliers, including provision for complaints processes and for the Commission to develop a service quality code.

In addition to the above, the Commission will have activities related to:

- **Establishment of regulatory requirements and systems** including its development of guidelines, asset valuations, cost allocation methodologies, and its engagement with the local government water services sector to build its capability on issues facing the sector, and to assist regulated suppliers to understand their obligations.
- **Reporting** on its activities to Parliament.

Output activities will vary over time and across different water service suppliers

The Commission's activities will vary:

- Over time and regulatory periods, as it establishes and sets up its regulatory systems and prepares for the application of its discretionary regulatory tools.
- Across council water service suppliers depending on their characteristics and performance, and the Commission's decisions on which regulatory tools to apply to each supplier's regulation.

Initially, economic regulation will only apply to the delivery of council drinking water and wastewater services. The legislation will enable the scope of economic regulation to be extended to council provided stormwater services through designation by Order in Council. The Chatham Islands will be exempt from regulatory requirements and a bespoke approach will be taken to transitioning Watercare into the regulatory regime (see discussion below).

In the first five years of regulation of water service suppliers, the focus of the Commission will be on:

- establishing regulatory requirements,
- implementing information disclosure, and

- administration of financial ringfence rules and revenue thresholds and other preparatory work including its development of guidelines, asset valuations, and cost allocation models.

These ‘core’ regulatory activities will apply to all regulated water service suppliers.

Once core regulatory requirements are established and applied, the Commission will make recommendations to the Minister on making quality, performance requirements and price quality regulation available. As a result of these decisions, different combinations of regulatory tools will likely apply to future regulation of individual water service suppliers.

Watercare’s bespoke interim economic regulation

Auckland Council’s Watercare will be subject to a bespoke interim economic regulation regime under the Local Government (Water Services Preliminary Arrangements) Act 2024 (**the Preliminary Arrangements Act**). Under this legislation, the Commission has been appointed as the Crown Monitor, responsible for monitoring Watercare’s compliance with the Watercare Charter (the Charter) which sets out minimum service quality standards and financial performance objectives. This Charter is currently under development and is expected to come into effect mid-2025. It will be implemented ahead of the Commission’s development and implementation of wider economic regulatory requirements under Bill 3.

As Crown Monitor, the Commission can require Watercare to provide any information it considers necessary to perform or exercise its functions, duties or powers under the Preliminary Arrangements Act.⁴ The Commission must also monitor Watercare’s performance under the Charter.⁵

It is intended that Watercare will become subject to economic regulation as other water service providers under Bill 3. This means that Watercare, alongside all other regulated water services suppliers, will be subject to the same core regulatory requirements (information disclosure etc) while the Charter providing for bespoke regulation is still in effect. It is also intended that at the end of the interim Charter period, Watercare will transition to price-quality regulation ahead of other water service providers.

The chart below provides a summary of the timing and sequencing of core regulatory activities that will apply to all regulated parties, and the establishment of additional regulatory tools that will apply to some but not all regulated parties. It also shows how Watercare will become subject to price quality regulation ahead of other water service providers.

⁴ Section 70.

⁵ Section 71

Output activities	Funding period	
	1st five years	2 nd five years
<i>Core regulatory activities (common to all regulated parties)</i>	Establishment and setup of regulatory requirements	
	Information disclosure Revenue thresholds Financial ringfencing Compliance monitoring Reporting	
<i>Bespoke to Watercare</i>	Price quality regulation	
<i>Additional regulatory activities (dependant on the characteristics and performance of individual water service providers decisions)</i>	Price quality regulation Performance requirements Quality only regulation Consumer protection (once regulations made)	

Provision for different classes of levies

Where practicable, we propose that the Commission’s costs related to a particular regulatory tool should be recoverable from those regulated suppliers subject to that regulatory tool at that time. We propose that the levy regulation should specify a method for calculating the levies and providing for different levies for classes of suppliers or services. This approach is summarised in the table below.

Activities for which levy payable	Description	Regulated suppliers who must pay levy
Core regulation of water services	Activities that will apply to all regulated water service suppliers including information disclosure requirements, setting rules on core metrics such as asset valuation and cost allocation, performance monitoring and reporting, and compliance investigations; the costs of other regulatory tools, including revenue thresholds, monitoring the financial ringfence and preparatory costs for additional regulation, are also included.	All regulated suppliers

Activities for which levy payable	Description	Regulated suppliers who must pay levy
Performance requirements	Performance requirements may apply to any regulated supplier following designation from 1 January 2026.	Only regulated suppliers subject to performance requirements
Quality only regulation	Quality only regulation may apply to any regulated supplier following designation from 1 January 2026.	Only regulated suppliers subject to quality only regulation
Price-quality regulation	Price-quality regulation may apply to any regulated supplier following designation. The Commission will incur costs relating to setting and administering price-quality regulation. This form of regulation could be imposed from 1 July 2026.	Only regulated suppliers subject to price-quality regulation
Consumer protection measures ⁶	The Bill will enable consumer protection measures to be introduced by regulation, if required. The Commission may also have a role in relation to service quality codes. If regulations relating to consumer protection measures are made, we anticipate that the Commission's costs will be separately identified and recovered from regulated suppliers at that time.	Only regulated suppliers subject to consumer protection measures
Class of waters (stormwater)	Economic regulation will initially apply to water supply (drinking water) and wastewater services only. If stormwater services are subsequently designated as subject to the economic regulation regime, we anticipate that the Commission will develop and apply tailored regulatory tools (eg information disclosure requirements) for regulated suppliers of stormwater services. These costs may be recovered from those regulated suppliers at that time.	Only regulated suppliers of stormwater services

The alternative to the proposed approach would be to charge each water service supplier a flat levy to recover its proportion of all of the Commission's costs of regulating all water services suppliers, irrespective of whether or not particular tools are applied to the regulation of a water service supplier.

Instead, the recommended approach is more equitable, justifiable and transparent in that the levy paid by a particular water service supplier will better relate to the mix of regulatory tools and activities that are applied to its regulation. While the recommended approach will be more administratively complex to administer compared to a single flat levy, it will be less complex than attempting to directly charge a supplier for the Commission's actual costs in its

⁶ Cabinet Paper and Minute of Decision, Local Water Done Well Stage 3: Further Decisions, CAB-24-MIN-0277.03, proactively released and available here: [https://www.dia.govt.nz/diawebsite.nsf/Files/Proactive-releases-2024/\\$file/Paper-3-Local-Water-Done-Well-stage-3-further-decisions-redacted.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Proactive-releases-2024/$file/Paper-3-Local-Water-Done-Well-stage-3-further-decisions-redacted.pdf)

regulation of the supplier, which would require complex time recording and activity cost allocation to a particular supplier.

The table below summarises an assessment of the two approaches against the objectives for the Commission’s funding.

	A single flat levy covering all of the Commissions costs in regulating all water service providers	Levies to recover the Commissions costs for different regulatory tools and activities
Equity – levy charges should be distributed fairly and equitably among regulated water service suppliers	Less equitable, a single flat levy will disadvantage water services providers that are only subject to core regulatory requirements, because they will cross subsidise the cost of interventions such as price quality regulation that will only apply to some water service suppliers.	Yes, levies paid by individual water service suppliers will better reflect the mix of regulatory tools and interventions applied to them.
Efficiency – the approach to charging should support the financially sustainable and efficient delivery of water services by encouraging compliance with regulatory requirements, while also being cost efficient to administer.	Yes, simple and cost efficient to administer. The approach will not directly expose a provide to its costs of regulation.	Yes, still relatively simple and cost efficient to administer compared to direct charging through a fee. Will better expose a water service provider to the costs of regulating it.
Justifiability – The costs recovered through levy should reasonably relate to the regulatory services being charged for, and, where possible, cross-subsidisation should be eliminated.	Less justifiable, as some water service suppliers will be levied for the costs of regulatory tools and activities that they are not subject to.	Yes, regulated water service suppliers will be levied for the costs of the regulatory tools and activities that they are exposed to.
Transparency – the approach to setting and administering the levy should be open and understandable and support the accountability of the Commission to Parliament and the public for its funding and its regulation of water service providers. This requires transparent processes in place for setting and managing fees and levies. It is about providing enough information to fee and levy payers so they can understand and assess charges	Yes, the levy that a water service supplier pays will be based on a transparent approach to its calculation.	Better, because the levy will be both transparent in its calculation and will also relate better to the regulatory tools and activities that it is subject to.

Cost Estimates

The table below summarises estimates for each of the main regulatory activities over the first five years of regulation. It is intended that all of these costs will be funded by the recommended levy on water service providers. The price quality regulatory costs are based on the assumption that price quality regulation will only be applied in the first five years of regulation to Watercare. All other water service suppliers will be subject to a similar regulatory package that is focused on information disclosure.

The appropriation would be capped, which means that the Commission would have incentives to operate efficiently and effectively within the appropriation over the period, and returns any unspent funds to the Crown.

Financial year	2025/26	2026/27	2027/28	2028/29	2029/30	Total
Core regulation	\$6.50m	\$6.50m	\$6.50m	\$6.50m	\$6.50m	\$32.50m
Performance requirements	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m
Quality only regulation	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m
Price-quality regulation	\$0.00m	\$0.00m	\$1.00m	\$0.50m	\$0.50m	\$2.00m
Consumer protection measures	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m
Stormwater regulation	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m	\$0.00m
Total cost	\$6.50m	\$6.50m	\$7.50m	\$7.00m	\$7.00m	\$34.50m

Ministers have agreed that the Commission's expenditure for core regulation of water services should be capped at no more than \$6.5 million per year, unless otherwise agreed following a review. Within core regulation, the Commission is expected to:

- In 2025/26, set initial information disclosure requirements, with summary and analysis beginning from 2026/27. The costs of administering these core information disclosure regulations continues in outyears.
- In 2026/27, carry out preparatory work for setting a price-quality path for Watercare. From 2026/27, the Commission may also develop methods and approaches to determine revenue thresholds and develop rules on core metrics such as asset valuation and cost allocation (in advance of input methodologies).

In relation to other regulatory activities, the above estimates assume that:

- Stormwater is not designated during this period.
- No consumer protection measures are introduced in this period.

- From 1 July 2028, Watercare will become subject to a new price-quality path. A year before Watercare’s price-quality path under the Bill comes into effect (i.e. 2027/28) the direct costs incurred in preparing Watercare’s price-quality path is allocated to Watercare. Once price quality paths are in place, ongoing monitoring costs will be incurred.
- Quality only and Performance requirements regulations are not designated during this period.

Apportionment of costs across regulated water service providers

It is recommended all of the Commission’s costs relating to economic regulation of water services (with the exception of litigation costs that are to be funded from the Commission’s litigation fund) should be recovered via a levy apportioned on the basis of the water service supplier’s district’s share of the normally resident population as counted in the latest Census of Population and Dwellings.

Consideration has been given to alternative options for how best to apportion the Commission’s costs across regulated water service suppliers. The options considered are to apportion costs based on:

- the number of persons resident in the water service suppliers district of service, based on the count from the most recent Census of Population and Dwellings, or
- the number of business and household connections to the water service supplier’s networks, based on data to be provided by the water service supplier.

It is proposed that for the first five years the Commission’s costs should be apportioned on the basis of the number of residents as counted in the latest Census of Population and Dwellings. While it would be more equitable to apportion costs on the basis of the number of connections as some people reside in areas that are not serviceable, there are data constraints and administrative complexity in doing so. Similar constraints would also apply to other means of apportioning such as the number of household and business customers and the volume of water services provided. Options such as apportioning the levy based on length of network infrastructure were also considered, but they would disadvantage rural providers serving small populations over large geographic areas. Water for irrigation would only be covered by the economic regulation regime if it is supplied using drinking water infrastructure.

The table below summarises the two most viable options for apportionment against the funding objectives.

	Resident population at the time of the most recent Census (recommended option)	Number of connections to network infrastructure
Equity – levy charges should be distributed fairly and equitably among regulated water service suppliers	<p>Yes, a consistent approach is taken to apportioning costs across water service suppliers.</p> <p>However, the approach will likely result in some small cross subsidisation of urban water service suppliers with relatively large proportions of their</p>	<p>Yes, apportionment would be based on actual numbers of connections.</p> <p>This also could be to the relative disadvantage of rural water suppliers, as in larger urban areas a single connection in an</p>

	populations connected to their water services. This would be to the disadvantage of rural water suppliers with proportionately more of their population self-supplying their water services.	apartment block might serve multiple persons.
Efficiency – the approach to charging should support the financially sustainable and efficient delivery of water services by encouraging compliance with regulatory requirements, while also being cost efficient to administer.	Yes, the approach is simple and low cost to administer.	No, consistent information does not exist across councils to inform apportionment on this basis. The complexity and cost of accessing and applying the information would likely outweigh benefits of the approach. Over time as information improves this option will likely become viable.
Justifiability – The costs recovered through levy should reasonably relate to the regulatory services being charged for, and, where possible, cross-subsidisation should be eliminated.	Yes, this approach is as justifiable as possible given the information available. In most districts, excluding those with large rural populations, the proportion of normally residing population should be similar to the proportion of the serviced population.	No, the administrative complexity and cost in applying the approach is unlikely to be justified by the equity benefits.
Transparency – the approach to setting and administering the levy should be open and understandable and support the accountability of the Commission to Parliament and the public for its funding and its regulation of water service providers. This requires transparent processes in place for setting and managing fees and levies. It is about providing enough information to fee and levy payers so they can understand and assess charges	Yes, this information is available which supports a transparent approach to setting and administering the levy.	No, Information to implement the option is not consistently available.

Impact analysis

The allocation of costs has been estimated across the 67 council districts based on the resident population of each district. Over time it is expected that the number of regulated suppliers will shrink to less than the number of councils because consolidation of water services suppliers across councils. It is assumed that because of councils' reorganisation of their water services, the number of regulated water service providers will drop to 50.

The table below shows the impacts of apportioning the estimated costs of regulating water services providers across the current council districts.

Indicative estimate of levy by regulated supplier in first two years

Regulated supplier (eg Council or service organisation)	2023 Census Population	Percentage of Total Population	Indicative levy 2025/26	Indicative levy 2026/27
Ashburton district	34,746	0.7%	45,231	45,231
Watercare - Auckland	1,656,486	33.2%	2,156,341	2,156,341
Buller district	10,446	0.2%	13,598	13,598
Carterton district	10,107	0.2%	13,157	13,157
Central Hawke's Bay district	15,480	0.3%	20,151	20,151
Central Otago district	24,306	0.5%	31,640	31,640
Christchurch city	391,383	7.8%	509,485	509,485
Clutha district	18,315	0.4%	23,842	23,842
Dunedin city	128,901	2.6%	167,798	167,798
Far North district	71,430	1.4%	92,984	92,984
Gisborne district	51,135	1.0%	66,565	66,565
Gore district	12,711	0.3%	16,547	16,547
Grey district	14,043	0.3%	18,281	18,281
Hamilton city	174,741	3.5%	227,470	227,470
Hastings district	85,965	1.7%	111,905	111,905
Hauraki district	21,318	0.4%	27,751	27,751
Horowhenua district	36,693	0.7%	47,765	47,765
Hurunui district	13,608	0.3%	17,714	17,714
Invercargill city	55,599	1.1%	72,376	72,376
Kaikoura district	4,215	0.1%	5,487	5,487
Kaipara district	25,899	0.5%	33,714	33,714
Kapiti Coast district	55,914	1.1%	72,786	72,786
Kawerau district	7,539	0.2%	9,814	9,814
Lower Hutt city (Wellington Water)	107,562	2.2%	140,020	140,020
Mackenzie district	5,115	0.1%	6,658	6,658
Manawatu district	32,415	0.6%	42,196	42,196
Marlborough district	49,431	1.0%	64,347	64,347
Masterton district	27,678	0.6%	36,030	36,030
Matamata-Piako district	37,098	0.7%	48,293	48,293
Napier city	64,695	1.3%	84,217	84,217
Nelson city	52,584	1.1%	68,452	68,452
New Plymouth district	87,000	1.7%	113,253	113,253
Ōpōtiki district	10,089	0.2%	13,133	13,133
Ōtorohanga district	10,410	0.2%	13,551	13,551
Palmerston North city	87,090	1.7%	113,370	113,370
Porirua city (Wellington Water)	59,445	1.2%	77,383	77,383
Queenstown-Lakes district	47,808	1.0%	62,234	62,234
Rangitikei district	15,663	0.3%	20,389	20,389
Rotorua district	74,058	1.5%	96,405	96,405
Ruapehu district	13,095	0.3%	17,046	17,046
Selwyn district	78,144	1.6%	101,724	101,724

Regulated supplier (eg Council or service organisation)	2023 Census Population	Percentage of Total Population	Indicative levy 2025/26	Indicative levy 2026/27
South Taranaki district	29,025	0.6%	37,783	37,783
South Waikato district	25,044	0.5%	32,601	32,601
South Wairarapa district	11,811	0.2%	15,375	15,375
Southland district	31,833	0.6%	41,439	41,439
Stratford district	10,149	0.2%	13,212	13,212
Tararua district	18,660	0.4%	24,291	24,291
Tasman district	57,807	1.2%	75,251	75,251
Taupō district	40,296	0.8%	52,456	52,456
Tauranga city	152,844	3.1%	198,966	198,966
Thames-Coromandel district	31,995	0.6%	41,650	41,650
Timaru district	47,547	1.0%	61,895	61,895
Upper Hutt city (Wellington Water)	45,759	0.9%	59,567	59,567
Waikato district	85,968	1.7%	111,909	111,909
Waimakariri district	66,246	1.3%	86,236	86,236
Waimate district	8,121	0.2%	10,572	10,572
Waipa district	58,686	1.2%	76,395	76,395
Wairoa district	8,826	0.2%	11,489	11,489
Waitaki district	23,472	0.5%	30,555	30,555
Waitomo district	9,585	0.2%	12,477	12,477
Wellington city (Wellington Water)	202,689	4.1%	263,852	263,852
Western Bay of Plenty district	56,184	1.1%	73,138	73,138
Westland district	8,901	0.2%	11,587	11,587
Whakatane district	37,149	0.7%	48,359	48,359
Whanganui district	47,619	1.0%	61,988	61,988
Whangarei district	96,678	1.9%	125,851	125,851
Total	4,993,254	100.00%	6,500,000	6,500,000

It is assumed that regulated water service suppliers will pass the costs of levies onto either the households and business that they directly provide water services to, or ratepayers in cases where water service suppliers do not have direct customer relationships. We note that some council water service suppliers directly charge connected customers for water services, while others recover their costs of providing water services through rates.

Based on the current resident population and an average household size of 2.7 persons, the annual financial impacts on households of the proposed levy will be small compared to the prices charged for water services through either rates or direct charges.

	2025/26	2026/27
Annual cost per person	\$1.30	\$1.30
Annual cost per household (2.7 people ⁷)	\$3.51	\$3.51

⁷ [https://www.stats.govt.nz/information-releases/family-and-household-projections-2018base-2043/#:~:text=The%20national%20projections%20\(medium%20B,2043%20\(an%20increase%20of%20474%2C000\)](https://www.stats.govt.nz/information-releases/family-and-household-projections-2018base-2043/#:~:text=The%20national%20projections%20(medium%20B,2043%20(an%20increase%20of%20474%2C000))

In rural areas where some households self-supply their drinking and wastewater, the impacts on the households that are directly connected to and directly charged for water services will be greater, but still small relative to the costs of water services.

Demand for water services will unlikely be impacted by the recommended levy

The proposed approach to apportionment of the proposed levy and the small annual household impact resulting from it is unlikely to impact on demand for water services, especially given that water services are an essential service.

Consultation

This Interim Stage 2 CRIS will be included with the levy proposal for purposes of consultation. The CRIS will be finalised following consultation. The final CRIS will note and address any issues raised in consultation with the proposed approach to levy funding.

The Commission, the Authority, the Department of Internal Affairs, the Treasury, the Ministry of Housing and Urban Development and the New Zealand Infrastructure Commission were consulted during policy development.

Conclusions and recommendations

It is recommended that the Commission's costs in regulating council water services suppliers should be recovered through a levy to be paid by water service suppliers. This is because,

- councils and their water services suppliers have given rise to the need for regulation;
- consumers of council water services providers will benefit from regulation.

It is recommended that the design of this levy should provide for the costs of different regulatory tools and activities to be levied, so that a regulated water service supplier pays a levy that is based on the actual mix of regulatory tools and activities that it is exposed to.

It is also recommended that initially the levy should be apportioned across regulated water service suppliers on the basis of their normally resident populations. While an alternative approach would be to apportion the Commission's costs on the basis of the numbers of households and businesses connected to a water service supplier's infrastructure, the information and data necessary to do this are not consistent across councils. As a result, an approach to apportioning levy costs on the basis of connections will initially be administratively expensive to implement for relatively little gain against the principles and objectives that the options were assessed against.

MBIE will monitor the Commission's performance in regulating council water service suppliers, and the Commission will be accountable to Parliament for its performance. The transparency of the recommended approach to funding, via an appropriation that is recovered through a levy administered by MBIE, will support accountability while also providing the funding certainty necessary for the independence of the Commission in its regulation of water services.

It is recommended that the approach to cost recovery be reviewed after two years in 2027/28. This is because there is some uncertainty in the numbers of providers that will be

regulated and how they will respond to regulation. This may have implications for the cost of regulation, and because information and data to inform different approaches to the apportionment of costs will likely improve as a result of more direct funding of water services in future.

Implementation plan

It is intended that the levy will be payable from 1 July 2025 and invoiced as soon as practicable after that date. Consistent with the existing levy recovery regime under Part 4 of the Commerce Act, MBIE will administer the levy on behalf of the Minister, including by:

- calculating the estimate of the Commission's costs at the start of the financial year, for that activity and apportioned to regulated suppliers at that time;
- invoicing regulated water services suppliers quarterly in advance.⁸

To manage risks associated with the estimating of the Commission's costs and apportionment of the levy across the assumed 50 regulated water service suppliers, a levy wash-up process is intended to occur annually to ensure the regulated suppliers only pay the Commission's actual costs. This would enable any underspend, or additional spend, to be returned, or recovered from regulated suppliers. The Commission's actual costs would be capped by the appropriation.

Under the proposed model, regulated suppliers will have flexibility to decide how best to fund payment of the levy. A council-controlled organisation that provides drinking water and wastewater services, for example, may choose to charge the households and businesses connected to its networks an equal amount.

Alternatively, a regulated supplier, such as a territorial authority that provides drinking water, wastewater and stormwater services in its district, may choose to pass on the levy through a targeted rate directed at connected properties for drinking water and wastewater services, and a targeted rate directed at ratepayers who own properties in an urban area for stormwater services.

It will be up to regulated water services suppliers to determine how to recover the levy costs from consumers (i.e., rates, water charges, etc.) and how to ensure these costs are recorded (i.e., whether to include levy charges as an explicit line in rates bills).

Monitoring and evaluation

It is proposed that the levy will be monitored and reviewed to ensure it continues to promote the objectives of equity, efficiency (including simplicity), justifiability, and transparency.

As monitor of the Commission, MBIE will advise on performance measures for the Commission in its regulation of council water service suppliers and will monitor the Commission's performance against these measures. The specification of performance measures will include specification of expected outputs (e.g quantity, timeliness and quality) and intended impacts. The Commission is required to report quarterly to MBIE on its

⁸ In the first year, transitional arrangements will allow for recovery of any Commission costs arising after 1 July 2025 and before the levy regulations are passed or before the regulated supplier becomes subject to the regime.

performance, which are discussed at quarterly meetings. Any issues arising may be escalated to the Commission board and responsible Minister.

The Commission will be subject to normal accountability arrangements to Parliament under the Crown Entities Act 2004 relating to its activities under the appropriation. This includes annual reporting and incorporating the new water services regime into its Statement of Intent and annual Statement of Performance Expectations. A Parliamentary Select Committee conducts an annual review of the Commission, which is open to the public.

The Commission also has regular meetings with the Minister to discuss performance, and other matters.

Review

A review of the Commission's appropriation and the levy is proposed after two years during FY2027/2028, unless issues are identified earlier. The Minister will consult regulated water services suppliers or their representatives as part of this funding and levy review.⁹

This review period recognizes that the regulation of council water services suppliers is new, and that arrangements for the delivery of local government water service suppliers will likely evolve quickly over this period with implications for the number and type of regulated suppliers. This will have implications for the Commission's approach and costs to regulate local government water service providers and potentially for the design of funding arrangements.

Over this period, it is also possible that the availability of data and information to inform apportionment of a levy will improve, such as apportionment based on connections rather than resident population.

⁹ This is consistent with other levy regimes to recover the Commerce Commission costs. For example, *Review of the Commerce Commission's funding for the regulation of Telecommunications and Fibre under the Telecommunications Act 2001, 2020* (available here: https://comcom.govt.nz/__data/assets/pdf_file/0025/229831/864dca4f85cbbcd308974b26bd56ef332fb88792.pdf)