

Auckland Council Group response to the Consultation on the Commerce Commission levy for the economic regulation of water services

Auckland Council and Watercare Services Limited (**Watercare**) have reviewed and considered the *Commerce Commission levy for the economic regulation of water services Discussion Document (Discussion Document)*.

Council's key points and critical concerns relating to this consultation are set out below using the online submission form question structure, in lieu of an online submission.

Summary of key submission points

- We have concerns about the proposal to recover, via a levy on regulated suppliers, 100% of the costs of the Commission's new functions (excluding litigation costs) at the same time that the water services sector is undergoing significant transition, for both existing water services providers and those to be formed.
- Auckland Council considers that the Crown should have a greater funding role of the Commission's core regulation of the water sector both during this transition period and beyond. This approach would be in line with the approach taken in some Australian states to regulating publicly-owned water entities.
- The preferred option in the discussion document for apportioning the levy would result in Watercare shouldering three streams of cost recovery related to the Commission's new regulatory functions for the sector. These would amount to significant additional costs for Watercare and, ultimately, Auckland consumers, covering the Crown Monitor costs from September 2024 including interim price-quality regulation from July 2025, core regulation from July 2025, and preparation for price-quality regulation under the new bill from July 2027.
- Auckland Council submits that the preferred apportionment option places a disproportionate burden on Watercare and Aucklanders as the 'first mover' for economic regulation. The cost apportioned is not representative of the effort required for Auckland. Interim regulation through the Watercare Charter and future price-quality regulation of Watercare will benefit other water suppliers subject to the regime and the sector as whole. It would be fairer to aggregate and recover the cost of establishing price-quality regulation from all regulated suppliers.
- The most equitable approach to apportionment of any levy for core economic regulation would be an even apportionment between the regulated water suppliers to reflect the similar resources expected to be expended by the Commission in relation to each regulated supplier. Another option, which does not appear to have been considered in the Discussion Document, is to group providers based on size and have a tiered system of charging.
- We note that Watercare has not accounted for the new costs from the Commerce Commission or Taumata Arowai levies in the preparation of its Business Plan to align with the new Watercare Charter and price-quality regulation. Watercare will require time to plan how to implement the levy regime in accounting systems and billing services as it is not straightforward to determine how it will apply to domestic and commercial customers in a way that is fair, equitable and transparent.
- Auckland Council supports a review of the adopted levy methodology aligned to the Long-term Plan cycle. A review cycle would also be able to incorporate the changes required if economic regulation is applied to stormwater.

• Part 1: Levy structure

1.

What are your views on the preferred option for a levy to fully recover the costs of the Commission's new functions from 1 July 2025 onwards from regulated water services suppliers, excluding litigation and Crown Monitor costs for Watercare? Please provide reasons.

Auckland Council understands that the Commission's new functions require funding. However, in the context of a rapidly changing sector, we question whether it is appropriate to be introducing a levy on water services suppliers who are working at pace to implement the various requirements of the Government's Local Water Done Well policy reforms at this time.

We have the following key concerns about the proposal to recover, via a levy on regulated suppliers, 100% of the costs of the Commission's new functions from 1 July 2025 onwards for regulation of water services suppliers ("**Preferred Option**"):

The Preferred Option in the Discussion Document would result in Auckland's Water Organisation, Watercare Services Limited, shouldering three streams of cost recovery related to the Commission's new functions. These would amount to significant additional costs for Watercare and, ultimately, Auckland consumers, outlined as below. These are, approximately:

\$2.156m per annum for the cost of core regulation (beginning 1 July 2025). Core regulation being information disclosure ("**ID**"), revenue thresholds, monitoring ringfencing obligations and preparatory costs for additional regulation;

\$1m initially (in 2027/2028) then \$500,000 per annum (from 2028/2029 onwards) for the cost of price-quality ("**PQ**") regulation; and

\$960,452 Crown Monitor costs, and \$417,506 in DIA costs associated with the preparation and monitoring of the Watercare Charter in 2024/5; and then \$1,435,020 in Crown Monitor costs from 2025/2026 onwards until enduring economic regulation is put into place.

The first regulatory period from 1 July 2026 (including the prior implementation period from 1 July 2025) will be a time of significant transition and establishment for new water services suppliers. The Interim Stage 2 Cost Recovery Impact Statement ("**CRIS**")¹ notes that the proposed approach of 100% recovery of costs through levy for the regulation of water services by the Commission is "consistent with other regulated services under Part 4 of the Commerce Act 1986". However, the fact that the water sector is undergoing a significant transformation period at the same time economic regulation is being introduced is a key differentiator to other sectors regulated under Part 4 of the Commerce Act. Those regulated industries were mature, well-established sectors at the time of Part 4 implementation.

A further difference between water services and gas / electricity lines services is the possibility of private sector ownership. Water services suppliers are statutorily prohibited from divesting any interests in water services infrastructure.² With no private equity investment, unlike other regulated sectors there is no profit motive associated with water services entities. Any returns are factored into the required investment and operating needs of the entity. One of the objectives of water services suppliers will be financial sustainability; profit-making ability will be naturally limited by the challenges facing the sector (at least in the near-medium future). Watercare is 100% owned by Auckland Council and subject to a statutory prohibition

¹ [Interim Stage 2 Cost Recovery Impact Statement: Commerce Commission Funding for Water Services Regulation](#) at (page 14)

² Clause 18, Local Government (Water Services) Bill

on distribution to its shareholders. This means that any costs or levies on Watercare will be passed through to consumers of water services i.e. Aucklanders.

Crown has a greater funding role

Furthermore, in the context of the supply of safe drinking water and environmentally appropriate wastewater services, which cannot be turned off or compromised for reasons of public health, the Crown has a greater role to play in funding the sector regulator.

For at least this initial regulatory period, Council submits that it is therefore appropriate for the Crown to fund the Commission's activities in respect of regulating water services. We suggest that the transitional Crown funding agreed to in FY2024/2025 to implement the foundational ID regime under the Preliminary Arrangements Act should be sustained and increased to fund the transition into and implementation of core regulation for the first regulatory period under the Local Government (Water Services) Bill ("Bill"). In this regard, we note that there was no intention to recover the potential costs of the foundational ID regime. As the Discussion Document notes, the cost of this is currently zero as there have been no designations, although Budget 2024 did approve transitional funding for 2024/2025 of \$2.232 million. Accordingly, there is unspent funding that could be contributed to the development of core regulation under Part 4. Given the foundational regime is now likely going to be core regulation, including ID, under Part 4, it would be a principled approach for the Crown to cover the costs of the Part 4 foundational regime too.

We further suggest that it is appropriate for the Crown to continue funding a portion of the Commission's activities in relation to regulating water services after the first transitional regulatory period. Government funding for the economic regulator of publicly owned water services suppliers is not unusual. For example, in Victoria, Australia, the Essential Services Commission receives approximately 21.8% of its total funding from the Department of Treasury and Finance. Victoria's water sector is made up of state-owned water corporations constituted under their Water Act 1989, analogous to the water organisations envisaged by the Bill.³

Existing water services suppliers, like Watercare, are also entering a time of significant transition. In addition to adapting to a new regulatory framework under Bill 3 and independently financing a significant capital expenditure programme, Watercare must comply with a binding price-quality path established in the Watercare Charter.⁴ Additional regulatory costs have not been considered in detail when creating Watercare's statutorily required Business Plan. If a levy regime is to be adopted, Auckland Council seeks careful evaluation of the burden being placed on Watercare, and Aucklanders, when they are already being charged with the costs of the Commission in respect of its role as the Crown Monitor (to monitor Watercare's performance under the Charter, which has recently been approved and will take effect from 1 April 2025). The costs of the Secretary of Local Government / DIA for preparation of the Charter are also recoverable from Watercare and therefore Aucklanders.

The Preferred Option proposes that the levy on regulated suppliers would be apportioned based on population in the regulated supplier district. Watercare, as the supplier to Auckland, would be apportioned 33.2% of the total cost / levy. It is not the case that Watercare would require a third of the Commission's resource during the first regulatory period for the establishment of the core regulation regime. We note that in addition to core regulation, Watercare will be subject to PQ regulation under

³ We understand that the economic regulators of water services in New South Wales (80-90%), Queensland (31%) and South Australia (20%) also receive funding from government appropriations to the extent indicated in brackets.

⁴ Section 84, Preliminary Arrangements A

	Bill 3, anticipated to commence on 1 July 2028 (being the end date of PQ regulation under the Charter). The Preferred Option is designed so that direct costs associated with this additional regulation are also recovered from Watercare. The cost burden is therefore disproportionately weighted to Aucklanders, who will be expected to shoulder the cost of setting up enduring PQ regulation while also facing additional individual levies.⁵
Part 2: Levy design	
2.	What are your views on the proposed levy design? Subject to our comments above that the Crown should fund the Commission's costs for at least the initial regulatory period, and continue to contribute to funding beyond that period, Auckland Council, in principle, supports costs relating to a particular regulatory tool being recoverable from those regulated suppliers subject to the regulatory tool. However, we have concerns that this approach could unfairly burden the "first mover" with the costs of establishing the regulatory tool. For example,⁶ while it is expected that Watercare may be the first water services provider subject to a PQ path under Part 4, Council expects that the Commission will consult broadly with the sector, and such consultation and regime development will likely benefit future suppliers that may be subject to that regime. In particular, if the Commission intends to develop input methodologies during the first regulatory period, these core methodologies relating to asset valuation and cost allocation are likely to be relevant to other suppliers subject to a future ID or PQ regime subject to input methodologies. Auckland Council also believes that the Commission will be able to utilise many of its learnings from its role as Crown Monitor when performing its functions under Part 4. Watercare should not be expected, individually, to shoulder the entire financial burden of the Commission's preparation of PQ regulation, as well as the Crown Monitor, when the benefits of these activities will be applied to the sector as a whole. Council proposes that these costs should be aggregated into core regulation of water services and recovered from all regulated suppliers (which means a "local government water service supplier" as set out by the Bill).
3.	How would the proposed levy design impact on your organisation (whether now or in the future)? Please provide your assessment of the nature and extent of these impacts.

⁵ Section 89, Preliminary Arrangements Act.

⁶ The Commission was appointed as the Crown Monitor for the interim regulation of Watercare in September 2024.

	Auckland Council supports and recognises the benefits of a robust economic regulatory regime for the New Zealand water sector. However, we are concerned that the Preferred Option does not meet the key considerations of equity and efficiency set out in Treasury's <i>Guidelines for Setting Charges in the Public Sector</i>.⁷ Auckland Council, Watercare and Aucklanders have heavily invested in water services supply over many years, resulting in Watercare being one of the high-quality, low-risk water services suppliers in New Zealand. We also note that Watercare has, and will continue to have, a statutory obligation to manage its operations efficiently with a view to keeping the overall costs to consumers at minimum levels consistent with the effective conduct of its undertakings⁸. In this context, we question the fairness of having Aucklanders shoulder the cost of setting up all types of regulation for water services in New Zealand, simply because Auckland will be the "first-mover". Arguably, the costs of setting up all types of regulation, including Price Quality Regulation, and the others set out at page 16 of the discussion document (i.e. Performance requirements, quality only regulation, consumer protection and stormwater regulation), will benefit the entire sector and should be aggregated into the core regulation of water services and recovered by from all regulated suppliers. We note that Watercare has not accounted for these costs in any of its work towards transitioning to operations under the new Local Water Done Well legislation. Watercare will require time to consider how any levy regime would be implemented in accounting systems and billing services to customers. Finally, in addition to the proposed levy, there are additional significant costs for water services providers in resourcing internal capacity to respond to and comply with new regulations. Auckland Council requests that the Commission give this due regard when developing the various regulatory tools to ensure regulation is efficient as possible.
4.	Do you have any comments on how the levy design could be improved? Please provide reasons.
	To summarise the points above, Auckland Council submits that: • It is appropriate in the case of water regulation for the Crown to fund the cost of the Commission in establishing and implementing core regulation for at least the initial regulatory period; • The Crown should also be required to support the costs of the Commission [at least to some extent] on an ongoing basis; • The proposal and design of the levies subjects Watercare to at least three separate categories of levies, which places a disproportionate cost burden on Watercare and Aucklanders. Crown funding would alleviate that burden and result in a fairer outcome; and • Watercare should not be expected, individually, to shoulder the entire financial burden of the Commission's preparation of enduring PQ regulation from 2027 -2030 when: a) Watercare would have already been subject to an

⁷ [Guidelines for Setting Charges in the Public Sector - April 2017](#) at (page 10)

⁸ Local Government (Auckland Council) Act 2009, section 57(1)

	interim PQ path from 1 July 2025; and b) the benefits of the Commission's interim PQ activities will be applied to the sector as a whole. Council proposes that the costs, post 2027 should be aggregated into core regulation of water services and recovered from all regulated suppliers.
Part 3: Levy apportionment	
5.	Do you have any comments on the preferred option for apportionment of the levy to each regulated supplier?
	The proposed apportionment based on population will result in Aucklanders bearing a third or more of the costs of setting up the entire economic regulation regime to be administered by the Commission. Auckland Council does not believe this approach is equitable to Aucklanders. See Q3 above. If the Crown does not fund the initial regulatory period, Council seeks an apportionment mechanism that does not result in it shouldering a disproportionate burden of one third of the Commission's costs of establishing and implementing core regulation. This is particularly the case during the time when Watercare is also paying for the Crown Monitor costs associated with the bespoke interim economic regulation under the Charter, which also includes implementation and compliance with a PQ path which applies from 1 July 2025.
6.	How would the proposed method of apportionment impact on your organisation (whether now or in the future)? Please provide your assessment of the nature and extent of these impacts.
	Any cost recovery through levies would require operational planning and technical implementation by Watercare. We note that the Discussion Document is silent on any technical considerations where a regulated supplier chooses to pass on any levy. If amendments are required to Watercare's accounting and billing systems (i.e. to pass through any levy to end-consumers), further costs will be incurred. It is also unclear whether there should be different considerations depending on end-customer type (i.e. domestic or business) when passing on any levy regime. In revenue and consumption, Watercare's end consumers are a mix of approximately 70% domestic customers and 30% business customers. In contrast, the split by number of connections is approximately 93% domestic connections and 7% business customers connections. There will be a significant amount of work required to ensure that the passing on of the levy to residential and business consumers is done in a fair, equitable and transparent way. We accept that a levy based on recovery of actual costs of services supplied by the Commission would be administratively difficult to implement. However, the Preferred Option would risk not delivering a fair outcome for Aucklanders, especially if more than 66% of the Commission's time and focus is spent on areas other than Auckland. Given this, increased Crown funding would ameliorate the impact of this. In addition, it might be appropriate to consider a capped total for specific, low-risk water services suppliers as an acceptable compromise between regulatory compliance burden and adequate funding of the Commission, so that one entity is not shouldering too much of the cost. Watercare will need to carry out substantive work and communication with our end customers to ensure any levy is passed on fairly. Watercare, and Auckland Council as its parent, are concerned that the proposal to commence the levy from as soon as

	July 2025 leaves very little time for these implementation complexities to be worked through in an equitable manner.
7.	Do you have any comments on alternative options to apportion the levy? If another option is preferred, please provide reasons.
	Auckland Council submits that the most equitable approach to apportionment of any levy for economic regulation would be even apportionment between the regulated water suppliers (i.e. 1/66th between all 66 regulated suppliers). This would amount to approximately \$98,500 for each regulated supplier and reflects the similar amount of resources which we expect would be expended by the Commission in relation to each regulated supplier. While we acknowledges that the cost of the levy would impact the financial viability of smaller regulated suppliers, exemptions can be sought. Where suppliers do face financial viability challenges, Auckland Council notes that councils do have the ability to enter into joint arrangements with other councils, and where a council is unable to contribute their share of the costs of the economic regulatory regime, this may be a catalyst for seeking or requiring different arrangements. Further, if the Commission does not expect to expend a similar amount of resources in respect of each regulated water supplier at this stage (under ID), we would expect forecast details of the amount of cross-subsidisation expected from other suppliers. Another option, which does not appear to have been considered in the Discussion Document, is to group councils based on size and have a tiered system of charging (ie small, medium, large, extra-large). In principle, this would mean the groups made up of larger councils, who tend to have a greater proportion of commercial customers, could more easily absorb the costs of the levy.
Part 4: Levy implementation	
8.	Do you see any issues with your implementation of the levy (receipt of invoices, payment and passing the cost on as you may determine)? If so, what are those issues?
	See comments above at Q6.
9.	Would the proposed implementation approach create any challenges for your organisation? If so, what would these be in practice and are there solutions you wish to propose?
	Before the levy is introduced, we recommend that the Commission / MBIE ensure it clearly articulates to the general public why water services are being regulated and the benefits this will bring to New Zealanders.
10.	Do you have a preference for when the levy should be reviewed next? If so, why?

Relatively frequent reviews are important given that the Preferred Option involves a levy methodology (rather than fixed levy costs) which may require reconsideration after implementation. Any review should involve substantive consultation with councils and other relevant stakeholders. If the levy continues to be industry funded, then a three-year review would be appropriate (we suggest this is aligned with the Long-Term Plan process).

Expenditure on core regulation is proposed to be capped at \$6.5m. While this cap will help to ensure the Commission is disciplined in its approach to expenditure, it will be equally important that there is a review/reporting mechanism by which the Commission's activities and spending are transparently reported on. Such reporting or auditing should also help assess whether the levy methodology ultimately adopted has been and remains appropriate in the context of a regular levy review (which as we note above, should be every 3 years in line with the Long-Term Plan process).

General Comments:

The Discussion Document sets out that the Commission's expenditure on core regulation of water services is forecast at \$6.5m per annum. This is also the cap set by Ministers for the Commission's expenditure on these activities. Little further detail on the makeup of these costs is provided (besides a list of the Commission's regulatory tools).

Auckland Council notes that stormwater services will not be regulated immediately by the Commission, however, there is an interface between the stormwater and wastewater networks in many regions which can necessitate, for example, capital or operating expenditure on combined wastewater / stormwater assets. Under the Preferred Option, only the wastewater services provider would be levied for economic regulation which might impact both services. We suggest that further detail on this type of complexity should be considered (even in high-level and draft form) and shared with stakeholders. We also question how the levy would be impacted or allocated if stormwater is brought into the economic regulation regime at a later date.

Regulations imposing any levy regime should also:

- Confirm whether recovery of the levy by Watercare is included in the maximum allowable revenue that Watercare may earn on water and wastewater services under the Watercare Charter. We submit that any levies specifically collected from customers should not be included in the maximum allowable revenue amount.
- Confirm that a territorial authority or CCO can pass on the levy to third party providers (such as Veolia who have the contractual relationship with end customers in Papakura).
- Confirm that there will be wash-up if the funding raised by a levy regime is not spent in a year.
- Confirm that the regulations will clarify that water services providers will have the discretion to choose how to pass on the cost of the levy to consumers.

Thank you

We appreciate you sharing your thoughts with us. Please find all instructions for how to return this form to us on the first page.