

GUIDANCE MATERIAL

PRICE DIFFERENTIATION PROTECTIONS (MULTI-COUNCIL WATER ORGANISATION)

BACKGROUND

This note sets out some principles and example clauses that shareholding councils in a multi-council water organisation can consider using and adapting to provide an additional layer of protection for shareholding councils (beyond the legislative protections detailed below) to ensure the water organisation prioritises cost efficiency in serving water users, maintains a charging regime that is cost-based, and does not introduce harmonisation of charges without the relevant approvals ("Price Differentiation Protections").

This note assumes that responsibilities relating to one or more water services will be formally transferred by each council to the water organisation through a transfer agreement, as provided for under sections 12 or 15 and Schedule 2 of the Local Government (Water Services) Act 2025 ("Act").

This note also assumes that the transfer agreement specifies that the board of the water organisation will be responsible for making final decisions about the level of charges and revenue recovery for water services, rather than the shareholding councils making those decisions (either directly or by approving documents that contain those matters), given the latter may have implications for Local Government Funding Agency arrangements, and the application of economic regulation under the Commerce Act 1986.

LEGISLATIVE POSITION

Section 44 of the Act requires a territorial authority to prepare foundation documents for a water organisation it establishes. Foundation documents are defined in section 4 as:

(a) the shareholders' agreement (if there is more than 1 shareholder); and

(b) either—

(i) the organisation's constitution, if it has one; or

(ii) if the organisation does not have a constitution, all rules and other documents that establish or govern the water organisation.

Under section 45 of the Act, a water organisation must be a company incorporated under the Companies Act 1993 (unless an exemption is received from this requirement as provided for in section 64). Amongst other matters, the Companies Act provides that a director of a company must not act, or agree to the company acting, in a manner that contravenes this Act or the constitution of the company.

Section 224 of the Act requires shareholders in a water organisation to prepare and adopt a statement of expectations, and provide this to the organisation at least six months before the organisation is required to prepare a water services strategy. The water organisation is required (under section 226) to give effect to the statement of expectations provided by shareholders.

Section 17 of the Act requires water organisations – as water service providers – to (amongst other things) ensure that they provide water services in a cost-effective and financially sustainable manner, including by:

- (a) planning effectively to manage water services infrastructure used to provide water services in the future; and
- (b) sharing the benefits of efficiency gains with consumers, including when setting charges for water services; and
- (c) using water resources efficiently when providing water supply services.

Section 18 of the Act sets out the financial principles that apply to water organisations, as water service providers, including that:

- (a) the provider must spend the revenue it receives from, and funding it receives for, providing water services on the water services it provides (including on maintenance, improvements, infrastructure renewal, servicing debt relating to the services it provides, and providing for growth);
- (b) the provider must ensure that the revenue and funding it applies to providing water services is sufficient to sustain the provider's long-term investment in its water services while meeting all regulatory requirements;
- (c) the provider's revenue and funding (including from charges), expenses, and dividends (if applicable) must be transparent to the public;
- (d) if the provider is a water organisation, it must be accountable to its shareholders for its revenue, funding, and expenses.

A water organisation must demonstrate compliance with the above principles in its financial operations and financial policies, and its planning and reporting documents prepared under Part 4 of the Act – including its water services strategy.

Clause 5 of Schedule 3 of the Act provides that the water services strategy must include – for each group of water services activities – the water organisation's intended approach to funding, revenue, and pricing. This must include detailed information on the following for the first three financial years to which the water services strategy relates:

- (a) the intended approach to pricing the water services it provides;
- (b) the intended approach to charging consumers; and
- (c) the intended sources of funding and revenue:

Any charges for water services set by the water organisation (under section 86 of the Act) must be set in accordance with its water services strategy. In practice, this means the strategy will need to include/implement any Price Differentiation Protections.

Under section 241 of the Act, the water organisation's water services annual budget must be consistent with the organisation's intended approach to funding, revenue, and pricing for the financial year, as set out in its water services strategy.

The water services strategy is prepared and adopted by the water organisation, in accordance with the statement of expectations set by the shareholding councils, and all the legislative requirements of the Act. The strategy must be consistent with the water organisation's responsibilities specified in its transfer agreement, and with its constitution (or other founding documents).

Part of the statutory purpose of the strategy is:

(a) for the water organisation to state publicly:

(i) the water services activities it intends to carry out to achieve the objectives specified in section 17 of the Act and any other outcomes; and

(ii) how the intended activities will contribute to the expectations, outcomes, or any other relevant matters set out in the water organisation's statement of expectations; and

(b) to provide a basis for the water organisation to be accountable to its shareholders for its performance in providing water services.

The purpose of the strategy is also to provide shareholders with opportunities to:

(a) participate in the water organisation setting its strategic intentions and performance framework; and

(b) influence the strategic direction of the water organisation.

Under section 236 of the Act, shareholders must determine the nature of their involvement in preparing and finalising the water services strategy, including whether:

(a) the shareholders will be able to, as necessary:

(i) provide comments on the draft strategy:

(ii) require the water organisation to amend the draft strategy:

(iii) approve the final strategy; or

(b) the shareholders will be able to provide comments on the draft water services strategy but will not have the power to require changes or approve the final strategy.

The shareholders must ensure that information on the nature of their involvement in preparing and finalising the water services strategy is included in the water organisation's constitution or other foundation documents (see comments under the "Constitution" heading below).

Further, while the water organisation may amend its water services strategy at any time, it must (among other things):

(a) give written notice to the shareholders of the water organisation of the proposed amendment; and

(b) consider any comments made by the shareholders on the proposed amendment (that are received by a date agreed between the water organisation and the shareholders, and that the shareholders make in accordance with the nature of their involvement set out in the constitution – as referred to above).

STATEMENT OF EXPECTATIONS

Principle:

Shareholders have flexibility about which matters to include in a statement of expectations – subject to the mandatory requirements in sections 227 and 228 of the Act. For example, a statement may contain a matter that applies:

(a) to all or a specified part of the water services provided by the water organisation (such as a matter that applies only to wastewater);

(b) to all or a specified part of the water organisation's service area (such as a matter that applies only to one shareholding territorial authority's district).

As noted above, a water organisation must give effect to its statement of expectations.

In the water services strategy (which sets out the intended approach to pricing), the water organisation must show how the activities in that document will contribute to meeting the statement of expectations. In the template documents, this is reinforced by the requirement on the water organisation's directors (in clause 12.14 of the template Constitution), to assist the water organisation to meet the requirements in the statement of expectations.

Accordingly, so long as the shareholding councils include the Price Differentiation Protections in the statement of expectations, then the water organisation will have to comply with those protections (unless the protections are inconsistent with directions or requirements imposed by a regulator, which will prevail in the event of any inconsistency).

Drafting:

The following text could be inserted into the statement of expectations for the water organisation:

Subject to meeting all of its legal obligations, and in accordance with any relevant direction or requirement imposed by a regulator, the water organisation is expected to:

- *maximise the cost efficiency of providing the water services; and*
- *not seek harmonisation of water services charges, and instead to apply appropriate price differentials in setting charges for water service users, so that those charges reflect the corresponding costs to serve those water service users.*

How to amend:

The shareholding councils must prepare and adopt a statement of expectations and provide it to the water organisation at least six months before the organisation is required to prepare its water services strategy. As each strategy relates to a period of at least 10 years, and continues in effect for three financial years, there will be a new statement of expectations to inform preparation of the new strategy every three years. Accordingly, shareholding councils will need to ensure that the Price Differentiation Protections are in each new statement of expectations.

[Note that there are additional requirements that apply in relation to the first statement of expectations for a new water organisation – see section 225.]

CONSTITUTION

Principle:

Directors of a company are required to ensure it acts in accordance with its constitution – meaning any requirement included in the Constitution must be complied with by the water organisation.

The Price Differentiation Protections should be included in the "Objectives" clause of the Constitution (clause 2 of the template Constitution) or, if more limited application of the Price Differentiation Protections is desired, should be included in the clause dealing with the approach to making the water services strategy and water services annual budget (clause 3.2 of the template Constitution).

As mentioned above, there is an opportunity for the shareholding councils to be involved in the process for preparing and finalising the water services strategy (clause 3.2 of the template Constitution).

Drafting:

The following text could be included in the Constitution:

2.2 The Company must not carry on any business other than the provision of water services and activities that are related to, or necessary for, the provision of water services. Such business must be carried on in order to:

(a) meet the objectives set out in section 17 of the Local Government (Water Services) Act for the [insert Service Area];

(b) maximise the cost efficiency of providing the water services; and

(c) apply appropriate price differentials in setting water services charges for water users, so that those charges reflect the corresponding costs to serve those water users.

3.2 The Shareholders shall be entitled to comment on the Company's draft water services strategy and draft water services annual budget, and the Company must consider those comments. However, the Shareholders will not have the power to require changes or approve the final strategy or final budget.

Option for an alternative clause 3.2 if clause 2.2 above is not used:

3.2 In preparing the Company's water services strategy and water services annual budget, the Company will maximise the cost efficiency of providing the water services and apply appropriate price differentials in setting charges for water users so that those charges reflect the corresponding costs to serve those water users. The Shareholders will be able to provide comments on each of the draft strategy and draft budget, which the Company must consider. However, the Shareholders will not have the power to require changes or approve the final strategy or final budget.

How to amend:

Any amendment to the Constitution will require shareholder approval by special resolution of at least 75% of shareholders entitled to vote and voting on the matter (this position, which is derived from the Companies Act 1993 is also reflected in the template Constitution). However, shareholding councils may increase this threshold in the Constitution, for example, by increasing the approval threshold to up to 100% approval/unanimous consent.

Further, the Shareholders' Agreement could designate an amendment of the Constitution to be a reserved matter, requiring a higher level of approval of the shareholding councils (this is currently provided for in the template Shareholders' Agreement at Schedule 3 of that document). The specified level of approval required must align with the level of approval required in the Constitution to make amendments to the Constitution.

**SHAREHOLDERS'
AGREEMENT**

Principle:

The parties to the Shareholders' Agreement (which may include the water organisation) are required to comply with the terms of the Shareholders' Agreement.

The template Shareholders' Agreement is drafted so that the purpose of the water organisation (clause 3.1) is to carry out the "Business". The Business then cross-refers to clause 2.2 of the Constitution as detailed above. Accordingly, if the Price Differentiation Protections are included in that clause of the Constitution, no additional provision is required to the Shareholders' Agreement to incorporate the Price Differentiation Protections.

If the Price Differentiation Protections have not been included in the Constitution, then clause 3.1 of the Shareholders' Agreement (the purpose clause in the template Shareholders' Agreement) should be replaced with the same wording as provided for in respect of clause 2.2 of the Constitution as set out above.

Drafting:

See above.

How to amend:

As the Shareholders' Agreement is a contract, this will usually require the approval of all parties to that contract to amend (this is provided for in the template shareholders' agreement). However, this threshold could be reduced if desired (e.g. by only requiring 75% of the parties to agree to the amendment).

The Department can provide further information or support to councils if required. Please contact wmdp@dia.govt.nz.

Please note that this note does not constitute legal advice. If unsure as to their position on any matter, councils should consider obtaining their own independent legal advice.