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Wellington Water – statement of proposal to become a shareholder in a council-controlled organisation

1. Purpose

The purpose of this report is to recommend that the Greater Wellington Regional Council (GWRC) adopt a statement of proposal (**Attachment 1**) and summary of information (**Attachment 2**) for consultation in accordance with the special consultative procedure under the Local Government Act 2002.

2. Background

Local authorities in the Wellington region (on request by the Mayoral Forum) have been considering ways in which they can collaborate more effectively through shared services. This is part of an overall drive to develop more effective and efficient practices under the Local Government Act 2002.

Water services have been identified as a priority area for consideration due to the nature of the network, and the similar but disaggregated roles of councils in the metropolitan part of the region.

GWRC owns and manages land and infrastructure to supply bulk water to Hutt City Council, Upper Hutt City Council, Porirua City Council and Wellington City Council (the Cities). This land and infrastructure includes water catchment areas, dams, reservoirs, water treatment plants, pumping equipment and pipes. GWRC's role in owning and managing infrastructure to supply bulk water to multiple territorial authorities is unique in New Zealand.

The downstream water infrastructure owned by the Cities is managed on their behalf by a council-controlled organisation called Capacity Infrastructure Service Limited (Capacity). Each of the Cities is a shareholder in Capacity. Capacity contracts separately with each of the Cities to provide infrastructure management services for water supply, wastewater and stormwater.

This paper puts forward a proposal to manage GWRC's bulk water supply assets on a network basis alongside (downstream) water supply, wastewater and stormwater services managed by Capacity. It does so in a way that:

- Retains public ownership of GWRC's bulk water supply infrastructure assets;
- Enables a strategic approach to, and the integrated management of, service delivery for the Wellington region's water supply network infrastructure;
- Enhances public accountability and maintains political oversight in relation to metropolitan Wellington's water assets; and
- Promotes cost-effectiveness over the long term.

3. Summary of the Proposal

In addition to retaining public ownership of bulk water infrastructure assets, there are advantages to managing these infrastructure assets on a network basis alongside water supply, wastewater and stormwater services managed by Capacity. In summary, the proposal is that:

- GWRC retains ownership of its bulk water infrastructure assets;
- GWRC becomes a shareholder in Capacity;
- Capacity is renamed "Wellington Water Limited", trading as "Wellington Water";
- The make-up of the board of directors for Wellington Water is changed from the current Capacity model;
- The board of directors for Wellington Water reports to a new committee of GWRC (the Water Committee) made up of five elected members - one representing each shareholder of Wellington Water;
- Each council retains a direct relationship with the board of directors via service level agreements and funding agreements;
- Staff currently employed by GWRC to manage its bulk water infrastructure assets transfer to Wellington Water;
- Some operational assets (but not infrastructure) transfer to Wellington Water; and
- GWRC contracts Wellington Water to manage its bulk water infrastructure assets.

4. Reasons for the proposal

Water supply is an essential service, vital to our health, quality of life and economic prosperity. Building, maintaining and operating water supply

infrastructure is expensive, so we need to make the most efficient use of our resources.

In the metropolitan part of the region, the supply is shared between GWRC (bulk water) and the four Cities (local distribution). This proposal is an opportunity to align the activities and provide a better service to the community. An improved ability to manage the water supply infrastructure in a strategic and integrated way, as well as the possibility of efficiency gains over the long term, are expected by taking a more coordinated approach.

While GWRC's water supply group has been operating very well in the current environment, the challenges faced in relation to water supply will increasingly require a strategic and integrated approach to managing the network infrastructure as a whole. Population growth may require us to increase our water supply capacity within the foreseeable future. Climate change will also impact on water supply. Increasing our water supply capacity will require capital investment.

The importance of integrated, strategic management of assets and service delivery is likely to increase in line with the scarcity of our water resource. For example, integration is likely to reduce the cost and improve the reach of water conservation measures and campaigns.

GWRC's long-term approach, as stated in its Long-Term Plan 2012-22 (page 72), requires that we:

... maintain and operate our existing water supply system to the highest standard and to be ready to provide additional sources of supply, when these are needed, to meet our growing population. We will also continue to work with the local authorities we supply and with the community to promote efficient and wise use of water. We will maximise opportunities to work with others and take a strategic approach to enable better long-term planning, increased cost effectiveness and enhanced operational capability. This includes taking the lead in developing a regional approach to the provision of bulk water supply in emergencies to improve resilience.

The proposals are also in-line with GWRC's stated operational values, which require GWRC to:

- Take a strategic and long-term view. Many of the issues we deal with are complex and span administrative boundaries and electoral timeframes. Taking a strategic and long-term view on planning and decision making ensures we put our efforts in the right place for current and future generations.

- Work towards shared solutions to shared issues. Issues such as freshwater management, land management, biodiversity, regional economic development and transport are shared issues that cannot be resolved by Greater Wellington in isolation. They require a collaborative approach with other key stakeholders, communities and agencies in local and central government.

This proposal is consistent with central government's policy of, and the Wellington Regional Mayoral Forum's commitment to, encouraging more collaboration and shared services between local authorities.

The objectives of the proposal are to manage GWRC's bulk water supply in a way that is optimal in terms of:

- Retaining public ownership of bulk water infrastructure;
- Enabling a strategic approach to, and the integrated management of, service delivery for the Wellington metropolitan water supply network;
- Enhancing public accountability and maintaining political oversight in relation to the management of the Wellington metropolitan water services; and
- Promoting cost-effectiveness over the long term.

5. Reasonably practical options

Consideration of this proposal requires the Council to think about all reasonably practical options to achieve GWRC's objectives. The reasonably practical options centre around two considerations - firstly, what is the best entity to manage GWRC's bulk water supply function; and secondly, if the answer is Capacity, what is the best way of structuring GWRC's relationship with Capacity?

The way GWRC funds its bulk water supply infrastructure and services (both capital and operational expenditure) would not change under the identified options. Currently GWRC recovers all of its water services costs by way of charges levied on the local authorities to which it supplies bulk water under the Wellington Regional Water Board Act 1972. The only difference under the options (other than the status quo) is that GWRC would use some of the water services charges it levies to pay for the costs of its contract for services with a council controlled organisation.

5.1 Status quo

As described above, the status quo is that the Cities contract with Capacity to manage their water services, whereas GWRC's bulk water supply function is managed in-house. The existing governance structure of Capacity is set out in an attached diagram (**Attachment 3**).

5.2 Establish a new council controlled organisation

GWRC could choose to establish its own council controlled organisation to provide management services for its bulk water assets. The new council controlled organisation could manage the bulk water supply functions under contract to GWRC. This would mean that two separate management entities would be responsible for the management of water services, ie, Capacity and the new council controlled organisation.

5.3 Become a shareholder in Capacity and contract with it, but make no other changes

Under this option GWRC would become a shareholder of Capacity in the same way as the Cities. This would allow GWRC to appoint a director to Capacity's board and participate in the existing shareholders' advisory group. See **Attachment 3**.

5.4 Become a shareholder in Wellington Water (Capacity re-named) and contract with it, and establish an oversight committee

Under this option Council would become a shareholder of Capacity in the same way as the Cities. In addition, its name would become Wellington Water and the membership of the board changed so that all of its directors would be independent. The board would report to a new Water Committee comprising one political representative from each of Wellington Water's shareholders. The Water Committee would be subject to the Local Government Official Information and Meetings Act 1987 and provide a forum for transparent political oversight and community involvement.

A diagram of this proposed new governance structure is at **Attachment 4**.

Consideration was given to the establishment of a new CCO to replace Capacity. PricewaterhouseCoopers considered some of the business aspects of a new council-owned company (NewCo). Its assessment is in **Attachment 5**. Before establishing NewCo, the Cities would, if they wanted to be shareholders, each be required to consult the public, as they would be establishing a new council controlled organisation. Capacity staff would transfer to NewCo and all the existing contracts held by Capacity would be need to be assigned or novated to NewCo. There are a number of costs and risks involved in establishing a new company that could be avoided by retaining Capacity (albeit with a name change). This option was therefore not considered appropriate and is not being presented as one of the four practical options.

6. Assessment of options

The options in this report need to be assessed in accordance with the Local Government Act 2002. This includes:

- Identifying the objective - what do you want to do and why?

- Assessing the options by considering:
 - The benefits and costs of each option in terms of the present and future interests of the district or region;
 - The extent to which community outcomes would be promoted or achieved in an integrated and efficient manner by each option;
 - The impact of each option on the GWRC's capacity to meet present and future needs in relation to its statutory responsibilities;
 - Any other matters which, in the opinion of GWRC, are relevant (such as existing policies).
- Giving consideration to the views and preferences of persons likely to be affected by, or to have an interest in, the matter.

The benefits and disadvantages/costs of each option have also been assessed against the following decision criteria which fit with GWRC's overall strategic direction:

- Ability to deliver high quality water services;
- Ability to enable more effective network service delivery via integrated services;
- Ability to enable more effective and integrated democratic decision-making;
- Ability to achieve step change cost efficiencies; and
- Ability to provide environmental protection and alignment with the ecosystem services approach to managing environmental decisions.

6.1 Assessment of the status quo

The status quo option has no transactional/establishment costs or uncertainty associated with change. However it is considered sub-optimal for implementing a strategic and long-term integrated approach to water management services and will not realise any long term cost efficiencies from scaling up management of water infrastructure and services. The status quo also provides the Cities with limited input into planning that will influence the future cost of GWRC's bulk water supply.

6.2 Establish a new council controlled organisation

This option is also unlikely to create new opportunities for improving the existing approach to strategic planning and integrated management, or for realising long term cost efficiencies. Given the costs, it is unlikely that the Cities would unwind Capacity to contract with an entity established by GWRC and, as a result, network integration is unlikely to be achieved. If a new entity was limited to providing services to GWRC, it would yield few benefits compared to the status quo of keeping GWRC's water supply group in-house.

6.3 Become a shareholder in Capacity and contract with it, but make no other changes

This is the easiest change option to implement. GWRC would (with the consent of the Cities) become a shareholder in Capacity; appoint a director to the board; become a party to the existing Shareholders' Agreement with the right to have a representative appointed to the existing Shareholders' Advisory Group; and enter into a Service Level Agreement with Capacity. Staff from GWRC's water supply group would transfer to Capacity.

This option would allow GWRC to participate, in its role as a shareholder, in matters directly related to the management and governance of Capacity, such as approval of the Statement of Intent. However, without further amendment to the Shareholders' Agreement and the scope of the Shareholders' Advisory Group, it would not grant to GWRC or the Cities any overarching governance role with regard to the region's water assets, nor would it enhance the public accountability of Capacity.

To gain some of the governance oversight desired, the Shareholders' Agreement could be amended in various ways, but it is considered that the overarching governance aims and efficiencies would be better met by selecting an alternative option.

6.4 Become a shareholder in Wellington Water (Capacity re-named) and contract with it, and establish an oversight committee

As this is the option recommended by this report, it is described in greater detail in the section below. This option would enable a more integrated and strategic approach to water management within the metropolitan part of the region. It would enhance democratic decision making by providing a forum for transparent political oversight of, and community involvement in, Wellington Water's governance arrangements, which includes water supply, stormwater and wastewater. It may also enable some long term cost efficiencies to be achieved resulting from scaling up the management of infrastructure under a single management company. And, like the Capacity option, it will allow for alignment of GWRC and the Cities' environmental objectives through the single management entity.

As with other change options, there will be some transactional/ establishment costs and uncertainty associated with the transfer of employees from GWRC's water supply group to Wellington Water. Under this option, each council retains a direct relationship with the board of directors via service level agreements and funding agreements.

7. Detailed description of the recommended option

7.1 Becoming a shareholder

There are currently two classes of shares in Capacity - equally held voting (Class A) shares and shares which reflect each shareholder's economic stake in the company (Class B). GWRC would be issued Class A shares which carried equal voting rights and would be expected to contribute financially by way of the Class B shares. If it were considered that Wellington Water has sufficient working capital, GWRC could purchase some of the existing Class B shares

from the Cities. However, it is more likely that further Class B shares would be issued to, and paid for by, GWRC. Depending on value, payment could occur through the transfer of operational assets.

As was done when Upper Hutt City Council and Porirua City Council became shareholders in Capacity, the appropriate proportion of Class B shares to be held by GWRC would need to be considered in light of the relative size of GWRC, and the extent of its water assets requiring management.

The company's constitution will need to be amended if GWRC becomes a shareholder, including changes to clause 3 regarding details of the shareholdings and clause 11 regarding the appointment of directors.

The existing Shareholders' Agreement will also need to be amended or (less likely) terminated entirely.

If the current arrangement of appointing directors to Wellington Water's board were followed when GWRC became a shareholder, the board could have five directors appointed directly by the participating councils, plus five independent directors appointed by the shareholders collectively. A board of ten directors would be unwieldy and, partly for this reason, it is recommended that a new framework be adopted.

A maximum of six directors would be ideal for Wellington Water. It is also recommended that each of these directors be independent. This would avoid the potential for conflicts of interest between the roles of elected member and company director, as well as improve the transparency of the political governance of Wellington Water and allow for a board comprised entirely of specialist directors with skills targeted to Wellington Water's business. The members of the Water Committee (under delegation from their respective local authority) would together appoint up to six directors.

As a shareholder in Wellington Water, GWRC would have input to the company's Statement of Intent. This provides a say in the strategic direction of the company and the approval of overall budgets for its administration and management. The integration of bulk water and downstream management services would foster broad consideration of strategic matters relevant to the water supply network.

Among other things, the Statement of Intent sets out the capital projects to be delivered by the company. These capital projects are, however, set by the individual entities contracting with Wellington Water (e.g. pursuant to Service Level Agreements) and are not dictated by the shareholding local authorities as a group. If GWRC wished to jointly fund a capital project, and this were agreed by the Cities, Wellington Water could manage this joint capital project either under the existing Service Level Agreements or pursuant to a bespoke contract. Ownership of the capital project would be retained by GWRC subject to any joint funding arrangements agreed with the Cities.

At a practical level, if GWRC considered that a new bulk water supply asset was needed (such as a reservoir), that decision would remain to be made by GWRC. As is currently the case, it would be up to GWRC to negotiate with other parties regarding issues such as cost sharing, access to suitable land and long term ownership. The other shareholders could not use GWRC's involvement with Wellington Water or the Statement of Intent process to prevent such a project from going ahead. That said, the governance structure recommended by this report may help to promote agreement about, and cost sharing in relation to, regional water supply infrastructure.

Renaming Capacity as Wellington Water would reflect:

- The integration of the management of the metropolitan region's water, wastewater and stormwater services;
- The fact that the nature of Capacity had changed; and
- A commitment to public ownership and management of the metropolitan region's water, wastewater and stormwater services.

7.2 Entering into a Service Level Agreement with Wellington Water

Wellington Water would manage GWRC's bulk water supply assets in accordance with a Service Level Agreement to be negotiated between the parties. The Service Level Agreements in place between Capacity and each of the Cities are on identical terms, save for certain schedules that are specific to each local authority. It is anticipated that most of the terms of these existing agreements would be included in GWRC's Service Level Agreement with Wellington Water, but a degree of tailoring is likely to be required.

Currently, Capacity manages both operational expenditure and capital projects on behalf of the Cities, although certain larger projects are kept outside of these arrangements. If GWRC becomes a shareholder of Wellington Water, it would similarly be able to elect, pursuant to its Service Level Agreement, which capital projects would be managed by Wellington Water. These capital projects would be recorded in the company's Statement of Intent but would be managed in accordance with the terms of the Service Level Agreement.

A Service Level Agreement between Wellington Water and GWRC would need to be in place prior to the company taking on any management services. This could coincide with the date on which GWRC becomes a shareholder of Wellington Water. However, depending on the timing of issues such as transferring GWRC employees, transitional arrangements may be needed.

The day-to-day operational aspects of these Service Level Agreements would be between Wellington Water and the individual shareholding local authorities. Any change to the overarching governance structure should not affect this.

7.3 Ongoing asset management

GWRC would retain ownership of its bulk water assets and would need to ensure it maintains sufficient access to resources and expertise to oversee the management of those assets by Wellington Water, including by providing input into Wellington Water's Statement of Intent and the programme of works to be carried out by Wellington Water on GWRC's behalf. This would include, for example, ensuring GWRC continues to meet its obligations under its Long-Term Plan and other legal requirements such those under health and safety legislation.

7.4 Relationship with iwi

Issues of interest to Maori will continue to be addressed through existing Maori representation arrangements on GWRC's Strategy and Policy Committee. Through these arrangements, Maori values would help to inform the development of GWRC's service level agreement with Wellington Water and any decision GWRC makes in relation to its infrastructure (e.g. investigating a new water source). Service level agreements are anticipated to include a requirement for Wellington Water to engage proactively with iwi on related matters.

7.5 Committee Governance options

Two committee options have been considered to provide a governance role.

7.5.1 Establish a joint committee

Under this option, Wellington Water would be established as a joint committee of the five local authority shareholders. This governance option is similar to the region's Civil Defence and Emergency Management Group which is a joint committee, albeit that committee is established by legislation which includes statutory membership and powers.

The joint Water Committee would be serviced by GWRC and it would elect its own chairperson and deputy chairperson. The extent of powers delegated to the joint committee would determine how it operates. For example, the joint committee could be directly delegated authority to make decisions regarding the management of Wellington Water in its own right (in other words, exercise the shareholders' power on their behalf).

Each shareholding local authority would retain individual decision making power in relation to specific projects funded through its Service Level Agreement.

There are some complexities to the setting up and on-going management of joint committees. To set up a joint committee, each of the Cities and GWRC would need to formally approve the terms of reference and standing orders. Any further changes (for example, changes to the terms of reference of the committee) would need to be formally approved by each council.

7.5.2 Establish a committee of GWRC (preferred option)

This option would have oversight of Wellington Water provided by a committee of GWRC. The Water Committee would be established by GWRC, with membership including representatives from the five local authority shareholders of Wellington Water. The Water Committee would be serviced by, and subject to, the standing orders of GWRC. The Water Committee would be responsible for electing its own chairperson and deputy chairperson. Each local authority would retain the ability to make individual decisions in relation to Wellington Water. Importantly, each local authority would retain, through its Service Level Agreement, control over what services Wellington Water provided to it and at what cost.

The existing Shareholders' Agreement would be replaced with a limited form of Shareholders' Agreement and the committee would provide more direct political oversight of Wellington Water. Some water services issues are of direct concern to the community and there are good reasons for debating them on a regional basis. Because the Water Committee's meetings would be in public, it would also provide a venue for members of the public to express an opinion.

This governance option is similar to the governance arrangements for the Wellington Regional Strategy and Regional Transport Committees - which have proven track records as successful and workable models.

While the Water Committee would not hold any delegated authority as a decision-making entity in its own right, GWRC and the Cities would agree to delegate some of their shareholder powers to their appointed member. This would allow the Water Committee to function and make decisions as a meeting of Wellington Water's shareholders.

At a minimum, each shareholder's power to comment on Wellington Water's draft Statement of Intent would be delegated to its representative on the Water Committee. This would allow the Water Committee to provide comments to Wellington Water in a collective and 'joined-up' way, in an environment that allows for public input/community views. Subject to discussion and agreement with the Cities, it is likely that each shareholder's power to approve the final Statement of Intent or seek a resolution to require the board of Wellington Water to modify its Statement of Intent would also be delegated to its representative on the Water Committee.

8. Employment and resource issues

There are a number of employment issues to be considered prior to transferring GWRC's water supply functions to a council controlled organisation. This section of this report considers the scenario of staff from GWRC's existing water supply group being transferred to Wellington Water (which would be their new employer), and the transfer provisions of Part 6A of the Employment Relations Act 2000 that would apply.

8.1 Vulnerable employees

There are specific employees who have special statutory protections under the Employment Relations Act 2000. These employees include those who provide cleaning services in the public service or local government sector. There is one cleaner employed in the water supply group who is based at the Wainuiomata Water Treatment Plant.

8.2 Other employees

Other employees, apart from the cleaner, are covered by the employee protection provisions of the Employment Relations Act 2000. Under the Act, all employment agreements must contain an employee protection provision, which is set out in clause 15(1) of GWRC's Collective Employment Agreement.

8.3 Employment Relations Act 2000 provision

The Act states that the employee protection provisions must include:

- A process that GWRC must follow in negotiating with the new employer (i.e. Wellington Water) about the proposed restructuring to the extent that it relates to affected employees; and
- The matters relating to the affected employees' employment that GWRC will negotiate with the new employer, including whether the affected employees will transfer to the new employer on the same terms and conditions of employment; and
- The process to be followed at the time of the restructuring to determine what entitlements, if any, are available for employees who do not transfer to the new employer.

If GWRC arranges for an affected employee to transfer to the new employer in relation to a restructuring, that affected employee may choose whether or not to transfer to the new employer.

8.4 Collective Employment Agreement / Individual Employment Agreement provision

GWRC's contractual obligations in relation to the above statutory requirement (as set out in the Collective Employment Agreement) are as follows:

- Where practical, affected employees must be consulted about any proposal for transfer to Wellington Water before a final decision is made.
- If proceeding with the proposal, GWRC must negotiate with Wellington Water to agree the basis upon which affected employees will be offered the same or similar terms and conditions of employment and recognise service as continuous. Affected employees must be advised of timeframes for such negotiation, including the proposed timeframes for the acceptance of any offer of employment or of any application and interview process, as soon as possible.

- GWRC is not required to pay redundancy if Wellington Water:
 - Offers the affected employees' employment; and
 - Agrees to treat the employee's existing service with GWRC as continuous service; and
 - Offers employment conditions the same as, or no less favourable than the employee's current conditions of employment, including superannuation; and
 - Offers employment in a similar capacity to that which the employee was employed with GWRC.
- If Wellington Water offers employment to an employee on terms and conditions that overall are less favourable and the employee accepts the offer, GWRC must pay compensation to the employee on the basis of one week's base salary payment for each complete year of current continuous service up to a maximum of 20 years.

Under GWRC's contractual provisions, there is an obligation to meet with the unions prior to any "contracting out" to discuss the rights and obligations of employees and to reach an agreement on how to protect staff from being disadvantaged in the case of any contracting out of the business. Although this clause specifically refers to "contracting out" rather than "transferring", it would be prudent to involve the unions at an early stage to discuss how GWRC would protect staff from being disadvantaged.

9. Community views

If further consideration of this proposal proceeds, consultation will take place using the special consultative procedure. This will help ascertain community views so that consideration can be given to them. As noted in part 8 of this report, GWRC will also need to meet the employment obligations it owes to its staff.

10. Risks

Legal advice in the form of a report has been obtained from DLA Phillips Fox and this has previously been provided to Councillors.

There is a considerable amount of detail to be resolved to put the preferred option in place, most of which will require agreement with the Cities.

Some of the other risks to manage as part of the process are discussed below.

10.1.1 Continuity of supply

Continuity of a quality water supply is paramount. Transferring staff from GWRC's water supply group will ensure that systems and knowledge transfer as well, so the risk of reduced performance over a short period is minimal. Some changes in structure may be desirable when the combined resources are considered, but these can be made in small increments within Wellington Water at a later date.

GWRC will retain the ultimate responsibility to ensure the community is provided with quality water at the wholesale level. Delivery will however rest with another organisation. Risks can be lessened by the terms of GWRC's Service Level Agreement, ensuring competent directors are appointed to Wellington Water, having an appropriate Statement of Intent and regular comprehensive reporting. GWRC will still need to allocate the funding to ensure its objectives can be met.

10.1.2 Quality independent advice to governance body

Following the transfer of staff from the water supply group to Wellington Water, GWRC will have limited in-house water supply resource at a technical level to advise on Wellington Water's performance and the long term management of the capital assets owned by GWRC. While Wellington Water will manage the bulk water assets and be under contractual obligation to ensure such services are carried out according to legal requirements, GWRC will retain residual responsibilities, including oversight in relation to health and safety.

10.1.3 Protection of GWRC assets

Governance of the bulk water supply system has traditionally been through a committee of GWRC with the occasional external appointee. Governance at a political level will in future be shared with the Cities. Careful drafting of the Water Committee's terms of reference and the revised Shareholders' Agreement will ensure GWRC can protect its interests, should the need arise. No doubt each of the Cities will want similar provisions. The risks in this area are seen as low. Water supply and waste water systems are at the forefront of public health.

The nature of GWRC's water supply functions and its part of the overall network infrastructure is different from that of the Cities. Any work Wellington Water does for GWRC will therefore be 'new' to some extent; as will the requirements of the Service Level Agreement between GWRC and Water Wellington. Any risks associated with this can be mitigated to some extent by transferring staff from GWRC's water supply group and careful negotiation and drafting of the Service Level Agreement.

10.1.4 Effective oversight and management of existing contracts

The extent to which existing water related works or services contracts held by GWRC can or should be assigned or novated to Wellington Water will need to be considered on a case by case basis. In some instances it may be appropriate for Wellington Water to act as GWRC's agent in those existing arrangements. There is precedent for this in Wellington Water's arrangements with the Cities and, as GWRC staff will be transferring to Wellington Water, there should be a degree of continuity in terms of personnel managing these contracts.

11. Financial

This proposal is intended to provide long term financial benefits by the integration of management of the three waters across the metropolitan part of the region, aligning service delivery and asset planning, and promoting cost effectiveness. The total assets of the three waters owned by the four Cities and GWRC amount to over \$2.5 billion with annual operating expenditure over \$105 million. With a significant investment in this critical infrastructure, long term planning and coordination of capital investments is vital.

GWRC and Capacity will incur a range of costs to implement this proposal and (with the Cities) to manage Wellington Water into the future. Offsetting the implementation costs will be long term gains expected to be achieved by operational efficiencies and integrated management of network infrastructure planning.

Estimates of costs that will be incurred are provided below. These costs are preliminary estimates and will be firmed up as the proposal is planned in greater detail.

- Project costs incurred during the development of this proposal which include the costs of legal advice from DLA Phillips Fox and the report prepared by PricewaterhouseCoopers. These costs will be allocated to the GWRC water group and should amount to less than \$100,000.
- Implementation costs which will include transition and first year costs. Both GWRC and Capacity will incur costs to implement the proposed governance changes, including the establishment of the new Water Committee and the other changes proposed to the constitution and the shareholders agreement. There will also be costs associated with the transfer of the GWRC employees, establishing the GWRC service level agreement and the transfer of operational assets to Capacity. Wellington Water is also expected to incur costs in the implementation of new management systems and to rebrand as Wellington Water.
- Capacity, currently have four shareholders with a total of 400 Class B shares valued at \$2 each share. GWRC will be required to invest to purchase an appropriate number of Class B shares. The number of shares and cost will be established prior to the final Council decision. We expect the operational assets required by GWRC to transfer to Wellington Water would, at least partially, fund the cost of the Class B Shares.
- GWRC's ongoing costs will include the cost of administering the new Water Committee, supporting GWRC's elected member on the Water Committee and the cost of monitoring Wellington Water's performance against the Statement of Intent and the service level agreement. This will require some resourcing, most of which will be managed within current staff resources.

All costs allocated to the GWRC water group will be passed on via the water levy to the four Cities. The GWRC water group currently includes in its operating costs, allocated overheads from GWRC Corporate. These costs will need to be reviewed in light of the services provided.

12. Consultation

The Cities have been consulted during the formulation of this proposal¹ and have had the opportunity to formally consider a draft Statement of Proposal.

Resolutions from each City, agreeing to the proposal in principle, are set out in **Attachment 6**.

Final agreements by each of the Cities will need to be negotiated if GWRC decides to proceed. A final proposal will then be put to each council for formal endorsement.

This proposal will also require communication with a range of different stakeholders. The following is a brief outline.

12.1 GWRC's staff

Communications to and consultation with staff will not only keep them informed of the process but also ensure the legislative requirements are met. GWRC management met with staff in the water supply group prior to Christmas to advise them of this proposal and any potential implications in relation to their employment. Discussion will be on-going.

12.2 Capacity

Our understanding is that Capacity staff were similarly informed of the proposal prior to Christmas. Discussion will be on-going.

12.3 Public

Although it is proposed that the public be consulted concurrently with GWRC's Annual Plan process, it is expected that initial messages will be well conveyed before the plan is published.

12.4 Iwi

As part of GWRC's partnership obligations, tangata whenua iwi will be consulted. Direct discussions will be held with Ngati Toa Rangatira and the Port Nicolson Block Settlement Trust.

13. The decision-making process and significance

The subject matter of this report is part of a decision-making process that will lead to the Council making a decision of medium significance within the meaning of the Local Government Act 2002. The decision-making process is explicitly prescribed for by section 56 of the Local Government Act 2002

¹ Note: this statement has been made ahead of the Cities considering this draft proposal. Once feedback has been received from the Cities the statement will be reviewed

requiring the use of the special consultative procedure before a local authority may become a shareholder in a council controlled organisation.

Section 97 of the Local Government Act 2002 does not apply to this proposal as it will not "alter significantly the intended level of service provision" for bulk water supply, and nor will it "transfer the ownership or control" of GWRC's bulk water supply assets to Capacity. As a consequence, the proposal will not require GWRC's current Long-Term Plan 2012-22 to be amended. However, because the proposal includes GWRC becoming a shareholder in a CCO, s 56 of the Local Government Act 2002 requires it to be adopted in accordance with the special consultative procedure.

Officers have also obtained advice that, aside from the process/decision-making requirements under the Local Government Act 2002, there are no legislative impediments to the proposed arrangement (including under the Wellington Regional Water Board Act 1972).

The proposed decision-making process is that:

- The four Cities will confirm their support in principle for this proposal.
- GWRC consider and adopt a statement of proposal (**Attachment 1**) and summary of information (**Attachment 2**) for consultation.
- Officers from GWRC and the Cities commence negotiating the details of a Water Committee and changes to the shareholders' agreement and constitution of Wellington Water. GWRC officers would commence negotiating a Service Level Agreement with Wellington Water.
- GWRC consult on the proposal using the special consultative procedure.
- Final approval by the four Cities
- GWRC consider submissions and make a final decision.
- GWRC execute the documents required to implement any decision that it makes.

14. Next steps

If GWRC adopts the statement of proposal the special consultative procedure will commence in tandem with GWRC's Annual Plan 2014/15 consultative process. At the same time as consultation is undertaken, a number of documents will need to be developed and agreed with various parties, including:

- Changes to the company constitution for Wellington Water
- A new, or amended, shareholders agreement
- A new service level agreement for GWRC

- Terms of reference for the new water committee
- Proposed delegations to elected members appointed to the water committee
- Schedule of assets and services contracts to be transferred from GWRC
- Process and arrangements for the transfer of staff from GWRC

The start date of the proposed operating model will be determined following completion of the above agreements, the outcome of public consultation, and the development of satisfactory staff transfer arrangements.

15. Recommendations

That the Council:

1. *Receives the report.*
2. *Notes the content of the report.*
3. *Notes the in principle support of Upper Hutt City Council, Hutt City Council, Wellington City Council and Porirua City Council for the statement of proposal.*
4. *Adopts the statement of proposal (Attachment 1) and summary of information (Attachment 2) for the purpose of using the special consultative procedure.*
5. *Delegates to the Chair the authority to make minor editorial changes to the statement of proposal and summary of information before they are published.*

Report prepared by:

David Benham
Chief Executive

WELLINGTON WATER – statement of proposal to become a shareholder in a council-controlled organisation

Overview

1. The Greater Wellington Regional Council (GWRC) supplies bulk water to Hutt City Council, Upper Hutt City Council, Porirua City Council and Wellington City Council (the Cities). GWRC owns and manages land and infrastructure to enable this bulk water supply. This land and infrastructure includes water catchment areas, dams, reservoirs, water treatment plants, pumping equipment and pipes. GWRC's role in owning and managing land and infrastructure to supply bulk water to multiple territorial authorities is unique in New Zealand.
2. The downstream water infrastructure owned by the Cities is currently managed on their behalf by a council-controlled organisation called Capacity Infrastructure Service Limited (Capacity). Each of the Cities is a shareholder in Capacity and Capacity contracts separately with each of the Cities to provide water infrastructure management services (water supply, wastewater, stormwater).
3. GWRC considers that, while retaining public ownership of bulk water assets, there are advantages to managing these infrastructure assets on a network basis alongside the downstream water supply, wastewater and stormwater services managed by Capacity. Over the medium to long term Wellington's metropolitan water services could be better delivered by integrating the management of the network infrastructure. In summary, the proposal is that:
 - 3.1 GWRC retains ownership of its bulk water infrastructure assets;
 - 3.2 GWRC becomes a shareholder in Capacity;
 - 3.3 Capacity is renamed "Wellington Water Limited" trading as "Wellington Water";
 - 3.4 The make-up of Wellington Water's board of directors is changed;
 - 3.5 Wellington Water's board reports to a new committee of GWRC (the Water Committee) made up of five elected members - one representing each of Wellington Water's shareholders;
 - 3.6 Each council retains a direct relationship with the board of directors via service level agreements and funding agreements;
 - 3.7 Staff currently employed by GWRC to manage its bulk water infrastructure assets transfer to Wellington Water;

- 3.8 Some operational assets (but not infrastructure assets) transfer to Wellington Water; and
- 3.9 GWRC contracts with Wellington Water to provide water infrastructure management services for its bulk water supply¹.
4. The purpose of this statement is to inform the public and seek feedback on the proposal. Any decision made by GWRC to implement the proposal will, however, be subject to GWRC finalising the details of agreements with the Cities. If final agreements cannot be reached, then the proposal will not proceed. The feasibility of the proposal has already been tested with the Cities; each of which has expressed support in principle².

Have your say

5. Submissions on this proposal may be made to GWRC and are welcomed. Submissions must be made in writing and sent either:
 - 5.1 By post to:

Wellington Water proposal
Freepost 3156
Greater Wellington Regional Council
PO Box 11646
Wellington 6142
 - 5.2 Or by email to: info@gw.govt.nz
6. Submissions must be received no later than 4 pm on [insert] 2014.
7. Any person or organisation who wishes to make a submission has a right to be heard in person by GWRC. Submitters who wish to be heard must request this in their submission.
8. Every submission:
 - 8.1 Will be acknowledged by GWRC; and
 - 8.2 May be made available to the public, including via GWRC's website.
9. The Local Government Act 2002 requires GWRC to make all written submissions on this proposal available to the public. This requirement is subject to the provisions of the Local Government Official Information and Meetings Act 1987. If you consider there to be compelling reasons why your details and/or submission should be kept confidential, you should explain this as part of your submission.
10. The consultation on this proposal will run concurrently with the Draft Annual Plan, as follows:

¹ This does not include management of the water supply catchment areas, which will continue to be managed by GWRC through its regional parks functions.

² Note: this statement has been made ahead of the Cities considering this proposal. Once feedback has been received from the Cities the statement will be reviewed

6 March 2014	GWRC adopted this statement of proposal and a summary of the information contained in it for consultation
24 March 2014	Submissions open
28 April 2014	Submissions close at 4 pm
27-28 May 2014	Submissions in person heard
12 June 2014	GWRC will consider submissions and the outcomes of the consultation process
26 June 2014	GWRC will make a final decision about the proposal

Background

11. GWRC collects water from rivers and an aquifer, treats it and provides it to the Cities. GWRC's aim is to provide a continuous and secure supply of safe, high-quality water in a sustainable and cost-effective way. It seeks to meet the reasonable water needs, both current and future, of the people living within the Cities' respective districts.
12. To achieve this aim, GWRC:
 - 12.1 Owns and operates four water treatment plants, 15 pumping stations and 183 kilometres of pipes. GWRC owns and manages assets with a value of \$464 million;
 - 12.2 Supplies on average approximately 140 million litres of water daily. More than half of this is used by households, the equivalent of two full bathtubs per person every day; and
 - 12.3 Plays an important role in ensuring that high-quality water is collected and distributed in a sustainable manner.
13. GWRC's role in bulk water supply is defined by the Wellington Regional Water Board Act 1972, but the manner in which this role is carried out is controlled by GWRC itself. The GWRC Water Supply Asset Management Plan (page 4) provides that GWRC is to:

Provide enough high-quality water each day to meet the reasonable needs of the people of greater Wellington, in a cost effective and environmentally responsible way.

This will remain GWRC's focus if this proposal is adopted and implemented.
14. More information about GWRC's existing bulk water supply activities can be found at:
 - 14.1 Long-Term Plan 2012-22 (<http://www.gw.govt.nz/long-term-plan/>)
 - 14.2 Water Supply Annual Report for the year ended 30 June 2013 (<http://www.gw.govt.nz/water/>).
 - 14.3 Water Supply Asset Management Plan (<http://www.gw.govt.nz/water/>)

15. Capacity is a council-controlled organisation under the Local Government Act 2002. It provides water management services (water supply, wastewater, stormwater) for the Cities. This includes providing planning, advice, design, project and operations management, maintenance, and monitoring relating to the assets and services of the water networks of the Cities. The Cities own the water infrastructure assets that are managed by Capacity. They also set all policies and performance objectives that are expected to be met.
16. Political oversight of Capacity is facilitated by a shareholders' advisory group consisting of representatives from the Cities.
17. Capacity's principal objectives, as set out in its statement of intent, are:
 1. *To operate as a cost effective, resilient and successful business, returning benefits to our shareholder councils and their communities.*
 2. *Through our people, to build a reputation for reliability, excellence, effectiveness, efficiency, courtesy and integrity, and as an organisation where people want to work.*
 3. *To develop and deliver sustainable and integrated service delivery and management of our clients' assets.*
 4. *To ensure the people of the Wellington region have safe reliable drinking water, effective wastewater collection and treatment, clean harbours, healthy streams and protection from flooding.*
18. Capacity has two different share classes. Voting shares (Class A) are held equally. Class B shares are held in differing amounts to reflect each City's economic stake in the company. Each of the Cities is entitled to appoint one director (in practice this is usually a councillor), and to jointly appoint independent directors to Capacity's board. There must be at least as many independent directors as councillors on the board. A copy of Capacity's constitution and details of its directors can be found at the Companies Office (www.business.govt.nz/companies).

Reasons for the proposal

19. The objectives of the proposal are to manage GWRC's bulk water supply in a way that is optimal in terms of:
 - 19.1 Retaining public ownership of bulk water infrastructure;
 - 19.2 Enabling a strategic approach to, and the integrated management of, service delivery for the Wellington metropolitan water supply network;
 - 19.3 Enhancing public accountability and maintaining political oversight in relation to the management of the Wellington metropolitan water services; and
 - 19.4 Promoting cost-effectiveness over the long term.

20. Water supply is an essential service, vital to our health, quality of life and economic prosperity. Building, maintaining and operating water supply infrastructure is expensive, so we need to make the most efficient use of our resources. Other local authorities in the region have similar water supply objectives, and this proposal is an opportunity to align those objectives and provide a better service to the community in the metropolitan part of the region. An improved ability to manage the Wellington metropolitan region's water supply infrastructure in a strategic and integrated way, as well as the possibility of efficiency gains over the long term, are expected by taking a more coordinated approach to tackling these objectives.
21. While GWRC's water supply group has been operating very well in the current environment, the challenges faced in relation to water supply will increasingly require a strategic and integrated approach to managing the network infrastructure as a whole. Population growth may require us to increase our water supply capacity within the foreseeable future. Climate change will also impact on water supply.
22. Increasing our water supply capacity will require capital investment and a continued focus on resilience planning.
23. GWRC's long-term approach, as stated in its Long-Term Plan 2012-22 (page 72), is to:

... maintain and operate our existing water supply system to the highest standard and to be ready to provide additional sources of supply, when these are needed, to meet our growing population. We will also continue to work with the local authorities we supply and with the community to promote efficient and wise use of water. We will maximise opportunities to work with others and take a strategic approach to enable better long-term planning, increased cost effectiveness and enhanced operational capability. This includes taking the lead in developing a regional approach to the provision of bulk water supply in emergencies to improve resilience.
24. GWRC's values and statements set out our overall approach and underpin the way we operate. They include:
 - We take a strategic and long-term view. Many of the issues we deal with are complex and span administrative boundaries and electoral timeframes. Taking a strategic and long-term view on planning and decision making ensures we put our efforts in the right place for current and future generations
 - Shared issues require shared solutions. Issues such as freshwater management, land management, biodiversity, regional economic development and transport are shared issues that cannot be resolved by GWRC in isolation. They require a collaborative approach with other key stakeholders, communities and agencies in local and central government
25. GWRC's proposal fits this long term approach and our stated values.

Assessment of options

26. GWRC has sought to identify all reasonably practicable options for achieving the objectives identified and described above. The main options are:
- 26.1 **Option A - Status quo:** Under this option GWRC would continue to manage bulk water supply in-house through its water supply group. GWRC would continue to have some regular customer meetings with the Cities' water supply activities beyond handing over bulk water at points of supply and recovering GWRC's costs pursuant to the Wellington Regional Water Board Act 1972.
 - 26.2 **Option B - Establish a new council-controlled organisation:** Under this option GWRC would establish its own 'version' of Capacity to undertake the management functions currently performed in-house by its water supply group.
 - 26.3 **Option C - Become a shareholder in Capacity and contract with it, but make no other changes:** Under this option GWRC would become a shareholder of Capacity in the same way as the Cities. This would allow GWRC to appoint a director to Capacity's board and participate in the existing shareholders' advisory group.
 - 26.4 **Option D - Become a shareholder in Wellington Water (Capacity renamed) and contract with it, and establish an oversight committee, replacing the current shareholders advisory group:** Under this option Council would become a shareholder of Capacity in the same way as the Cities. In addition, its name would become Wellington Water and the membership of the board changed so that all of its directors would be independent. The board would report to a new Water Committee comprising one political representative from each of Wellington Water's shareholders. The Water Committee would be subject to the Local Government Official Information and Meetings Act 1987 and provide a forum for transparent political oversight and community involvement.
27. These options have been considered against the following criteria and fit with GWRC's overall strategic direction:
- 27.1 Ability to deliver high quality water services;
 - 27.2 Ability to enable more effective network service delivery via integrated services;
 - 27.3 Ability to enable more effective and integrated democratic decision-making;
 - 27.4 Ability to achieve step change cost efficiencies; and
 - 27.5 Ability to provide environmental protection and alignment with the ecosystem services approach to managing environmental decisions.

28. In assessing the reasonably practicable options, GWRC is also required to consider:
- 28.1 The benefits and costs of each option in terms of the present and future interests of the region;
 - 28.2 The extent to which community outcomes would be promoted or achieved in an integrated and efficient manner by each option; and
 - 28.3 The impact of each option on GWRC's capacity to meet present and future needs in relation to its statutory responsibilities.
29. In addition to the criteria set out above, GWRC has considered a range of other matters that it considers relevant, including:
- 29.1 Its statutory obligations under s 130 of the Local Government Act 2002, the Wellington Regional Water Board Act 1972 and Part 2A of the Health Act 1956; and
 - 29.2 GWRC's existing policies and planning documents in relation to its water supply function.
30. GWRC's analysis of the main options is summarised below:

	Option A Status quo	Option B GWRC CCO	Option C Capacity	Option D Wellington Water
Ability to deliver high quality water services	✓	✓	✓	✓
Ability to enable more effective network service delivery via integrated services	X	X	✓	✓✓
Ability to enable more democratic decision-making	X	X	X	✓
Ability to achieve step change cost efficiencies	X	X	✓✓	✓✓
Ability to provide environmental protection and alignment with the eco-system services approach to managing environmental decisions	✓	✓	✓	✓

Explanation of the analysis

31. The status quo option has no establishment costs or uncertainty associated with change. However it will be sub-optimal for implementing a strategic and long-term integrated approach to water management services and will not realise any long term cost efficiencies from scaling up management of water infrastructure and services. The status quo also provides the Cities with limited input into planning that will influence the future cost of GWRC's bulk water supply.
32. Option B, establishing a GWRC company, would have establishment costs and uncertainty associated with change without any corresponding benefit over the status quo.
33. Joining Capacity, Option C, under the current arrangements would enable a more integrated and strategic approach to water supply within the metropolitan part of the region. It may also enable some long term cost efficiencies to be achieved resulting from scaling up the management of infrastructure investment under a single management company. A further benefit is that it will allow for alignment of GWRC and the Cities' environmental objectives through the single management entity. This option, however, would have establishment costs and uncertainty associated with the transfer of employees from GWRC's water supply group to Wellington Water. In addition, it would not significantly enhance the existing governance structure, political oversight or community involvement.
34. Option D, Wellington Water, would enable a more integrated and strategic approach to water management within the metropolitan part of the region. It would enhance democratic decision making by providing a forum for transparent political oversight of, and community involvement in, Wellington Water's governance arrangements. It may also enable some long term cost efficiencies to be realised from scaling up the management of infrastructure investment under a single management company. And, like the Capacity option, it will allow for alignment of GWRC and the Cities' environmental objectives through the single management entity. As with other change options, there will be some establishment costs and uncertainty associated with the transfer of employees from GWRC's water supply group to Wellington Water.
35. The preferred option that forms the basis of this proposal is Option D - Wellington Water.

Detailed description of the proposed option - Wellington Water

Becoming a shareholder in Wellington Water

36. The proposal is that GWRC is issued with the following shares in Wellington Water:
 - 36.1 The same number of voting (Class A) shares as are held by each of the Cities; and
 - 36.2 The number of Class B shares which reflects the extent of GWRC's water assets requiring management relative to the Cities'.
37. Any cost of becoming a shareholder in Wellington Water is likely to be small. No value is attributed to the Class A shares. The value exchanged for the Class B shares will need to be determined by subsequent negotiation with the Cities, but most of the payment by GWRC is likely to occur through the transfer of operational assets.

Changes to Capacity's constitution

38. GWRC's agreement to become a shareholder in Wellington Water would be made contingent on finalising agreement with the Cities that:
 - 38.1 Capacity is renamed "Wellington Water" and it uses the operational/trading name "Wellington Water"; and
 - 38.2 The make-up of the company's board is changed so that it is comprised of an appropriate number of independent directors (who are not elected members of the shareholding Councils) with specialist skills in relation to governing a water management services company. The board would remain publicly accountable and would be complemented by the political oversight achieved via the proposed Water Committee.
39. Some other more minor amendments to the existing constitution of Capacity may also be agreed, including changes to the current shareholders' agreement. This agreement sits alongside the constitution and establishes the shareholders' advisory group, the main functions of which would be overtaken by the proposed Water Committee.

Establishment of the Water Committee

40. GWRC's proposal to join Wellington Water would be made contingent on finalising agreement with the Cities that:
 - 40.1 A committee of GWRC is established under the Local Government Act 2002, with terms of reference to monitor Wellington Water's performance; receive half-yearly and annual reports from Wellington Water; receive draft and final statements of intent from Wellington Water; and provide comments on draft statements of intent.
 - 40.2 The Water Committee will comprise one elected member from each of GWRC and the Cities (i.e. each of Wellington Water's shareholders). The Water Committee will be serviced by, and subject the standing orders of, GWRC; but responsible for electing its own chairperson.
 - 40.3 While the Water Committee will not hold any delegated authority as a decision-making entity in its own right, GWRC and the Cities will agree to delegate some of their shareholder powers to their appointed member. This will allow the Water Committee to function and make decisions as a meeting of Wellington Water's shareholders.
41. The purpose of establishing the Water Committee includes:
 - 41.1 To co-ordinate the local authority shareholders' relationship with Wellington Water;
 - 41.2 To provide a forum for the shareholders to receive advice about, and reach agreement on, the strategic and integrated management of the Wellington metropolitan water services (i.e. water supply, wastewater and stormwater). This would include the management of GWRC's bulk water infrastructure;
 - 41.3 To allow for the political governance of Wellington Water in a way that avoids any conflicts of interest which may arise from appointing elected members as directors; and

- 41.4 To facilitate the transparency of, and public involvement in, the political governance function.

Contracting for water infrastructure management services

42. If the proposal proceeds, GWRC will need to contract with Wellington Water for the provision of infrastructure management services for its bulk water supply. A "service level agreement", initially based on the service contracts the Cities already have in place, will be negotiated. This service contract will determine what management services will be provided, what Wellington Water's obligations will be and the cost of the management services.
43. The date on which Wellington Water starts providing management services to GWRC and whether a phase-in period is required will need to be negotiated and agreed. It is envisaged the new management regime will start in the 2014/15 financial year.

Accountability and monitoring arrangements

44. Wellington Water will be answerable to GWRC:
- 44.1 Under the service contract;
 - 44.2 Through the accountability and monitoring obligations that council-controlled organisations and local authorities have under the Local Government Act 2002, including Wellington Water's statement of intent; and
 - 44.3 Through GWRC's role as a shareholder and its ability to influence the appointment of independent directors to the board of Wellington Water.
45. Each shareholder's power to comment on Wellington Water's draft statement of intent will be delegated to its representative on the Water Committee. This will allow the Water Committee to provide comments to Wellington Water in a collective and 'joined-up' way, and in an environment that allows for public input/community views. It is likely that each shareholder's power to approve the final statement of intent or seek a resolution to require the board of Wellington Water to modify its statement of intent will also be delegated to its representative on the Water Committee. This will need to be discussed and agreed with the Cities.
46. Wellington Water will also be accountable to the public through meetings of the Water Committee, as well as the publication of its statement of intent and half-yearly and annual reports.

Operational implications

47. The most significant operational impact will involve the approximately 60 GWRC employees that make up GWRC's water supply group. As GWRC's water management services will be carried out by Wellington Water, it is anticipated that the majority of the roles performed by these staff will be taken over by Wellington Water. An employment processes needs to be followed, including consultation with affected staff.
48. A significant portion of GWRC's water supply group is already located in buildings in Petone that are adjacent to Capacity. While all of the core bulk water supply infrastructure, including land, will remain owned by GWRC, some operational

assets (such as vehicles and some movable equipment) may be transferred to Wellington Water.

49. The proposal is not expected to have any impact on:
 - 49.1 The levels of service and asset management practises set out in the Water Supply Asset Management Plan, November 2012 (including maintaining ISO 9001 (quality) and ISO 14001 (environmental) certification in relation to bulk water supply);
 - 49.2 GWRC's aim to ensure that its assets are managed well and all relevant environmental standards, health and safety standards and water quality and supply targets are met.
50. The proposal will not negatively alter the intended level of service provision for bulk water supply, nor transfer the ownership or control of GWRC's bulk water supply assets to Wellington Water.

Relationship with iwi

51. Issues of interest to Maori will continue to be addressed through existing Maori representation arrangements on GWRC's Strategy and Policy Committee. Through these arrangements, Maori values would help to inform the development of GWRC's service level agreement with Wellington Water and any decision GWRC makes in relation to its infrastructure (e.g. investigating a new water source). Service level agreements are anticipated to include a requirement for Wellington Water to engage proactively with iwi on related matters.

Financial implications

52. Bulk water is supplied by GWRC under the Wellington Regional Water Board Act 1972. The Act determines how the costs of providing the bulk supply are shared among the Cities. GWRC charges the Cities a uniform charge for water supplied to them based on an apportionment of the bulk water costs relative to the amount of water used by each City. GWRC's costs of producing and distributing bulk water are levied on each City annually. GWRC will continue to set the levy and collect the uniform charge following consultation through its Annual Plan process. The Wellington Regional Water Board Act 1972 means the cost of bulk water supply is not funded by GWRC's rates, but rather by the Cities themselves, including through their rates. Any costs of, and the future savings arising from, the proposal will therefore be reflected in the amounts charged to rate payers by the Cities, rather than by GWRC.
53. This proposal is intended to provide long term financial benefits by the integration of management of the three waters across the Wellington metropolitan region, aligning service delivery and asset planning, and promoting cost effectiveness. The total assets of the three waters in the four Cities and GWRC amount to over \$2.5 billion with operating expenditure over \$105 million pa. With a significant investment in this critical infrastructure, long term planning and coordination of capital investments is vital.

54. GWRC and Capacity will incur some costs to implement this proposal and (with the Cities) to manage Wellington Water into the future. This will be offset over the long term by operational efficiencies and gains expected from the integrated management of network infrastructure planning.
55. A preliminary estimate of costs to implement this proposal include:
- Project costs incurred during the development of this proposal, including legal advice and technical reports. These costs will be allocated to the GWRC water group and should amount to less than \$100,000.
 - Implementation costs associated with transition. GWRC and Capacity will incur costs to establish the new Water Committee and change the constitution and the shareholders agreement. There will be costs associated to the transfer of GWRC employees and operational assets to the new entity, and preparing a new GWRC service level agreement. Wellington Water is also expected to incur costs to establish new management systems and to rebrand as Wellington Water.
 - Minor costs associated with the purchase of shares. Capacity, currently have four shareholders with a total of 400 B Class shares valued at \$2 each share. GWRC, as a new shareholder, will be required to purchase an appropriate number of B Class shares. These would likely be partially funded through the transfer of GWRC operational assets to Wellington Water.
 - Minor costs associated with the administration of the new Water Committee, including support for GWRC elected members and monitoring Wellington Water's performance against the SOI and the service level agreement.
56. All costs allocated to the GWRC Water Group will be passed on via the water levy to the four Cities. The GWRC Water Group currently includes in its operating costs, allocated overheads from GWRC Corporate. These overheads will need to be reviewed in light of the services provided.

Consultation

57. Please let us have your feedback. Details on how to make a submission are set out in the section "Have your say" above.

SUMMARY OF INFORMATION – integrated delivery of water services

Proposal to transfer Wellington metropolitan bulk water activities into an existing council-owned water management company (currently named Capacity Infrastructure Services Ltd)

Greater Wellington Regional Council (GWRC) supplies bulk water to Hutt City Council, Upper Hutt City Council, Porirua City Council and Wellington City Council (the Cities). GWRC owns and manages land and infrastructure to enable this bulk water supply. This includes water treatment plants at Te Marua, Waterloo, Wainuiomata and Gear Island as well as a network of pumping stations, pipes and reservoirs, including two storage lakes at Te Marua.

The downstream water infrastructure (wastewater, stormwater, drinking water) owned by the Cities is currently managed on their behalf by a council controlled organisation called Capacity Infrastructure Services Limited (Capacity). Each of the Cities is a shareholder in Capacity.

GWRC is proposing to contract the management of its bulk water supply operations to Capacity. At the same time it is proposed GWRC will become a shareholder in Capacity and change its name to Wellington Water Limited.

All land and bulk water supply infrastructure owned by GWRC will remain in public ownership under the proposal.

The objectives of the water integration proposal are to manage GWRC's bulk water supply in a way that:

- Retains public ownership of bulk water infrastructure
- Enables a strategic approach to, and the integrated management of, service delivery for the Wellington metropolitan water supply network
- Enhances public accountability and maintains political oversight in relation to the management of the Wellington metropolitan water services
- Promotes cost-effectiveness over the long term.

Managing GWRC's bulk water supply assets on a network basis alongside the downstream water services managed by Capacity will allow a more strategic approach to be taken for the

planning and delivery of these services. The associated economies of scale and operating efficiencies will yield benefits to the community in the longer term.

In summary, the proposal is that:

- GWRC retains ownership of its bulk water infrastructure assets
- GWRC becomes a shareholder in Capacity
- Capacity is renamed “Wellington Water Limited” trading as “Wellington Water”
- Wellington Water’s board reports to a new committee of GWRC (the Water Committee) made up of five elected members - one representing each of Wellington Water’s shareholders. Meetings of the committee will be in public
- The make-up of Wellington Water’s board of directors is changed so that all directors will be independent (not elected representatives)
- Staff currently employed by GWRC to deliver its bulk water services transfer to Wellington Water
- Some operational assets (but not infrastructure assets) transfer to Wellington Water; and
- GWRC contracts with Wellington Water to provide water infrastructure management services for its bulk water supply.

Each of the Cities will continue to have their own management agreement with Wellington Water and retain responsibility for setting water services charges and rates, setting service levels and capital works programmes.

As part of the proposal, GWRC will purchase shares in Capacity, the number to be agreed with the other councils. Payment for the shares could be offset by the value of transferred assets. There are some other costs GWRC will incur with the proposal. The initial project costs associated with the development of the proposal are unlikely to exceed \$100,000. The anticipated implementation costs are described in the detailed statement of proposal.

GWRC considered three other options: retaining the status quo; establishing its own water management company; and contracting with Capacity for the management of water services but not becoming a shareholder. These options and the preferred option were considered against GWRC’s strategic direction and policies. Contracting Capacity to manage GWRC’s water infrastructure assets and related services and becoming a shareholder was judged to be the best option.

The four councils affected by this proposal (Wellington City, Hutt City, Upper Hutt City and Porirua City) have been consulted. Each council has agreed in principle to the proposal. If

approved, the transfer of the management of GWRC's bulk water activities into Capacity is expected by the end of the 2014 calendar year.

A full copy of the Statement of Proposal can be viewed on the GWRC website www.gw.govt.nz/have-your-say or at the Regional Council offices Shed 39, Harbour Quays, Wellington and 34 Chapel Street, Masterton.

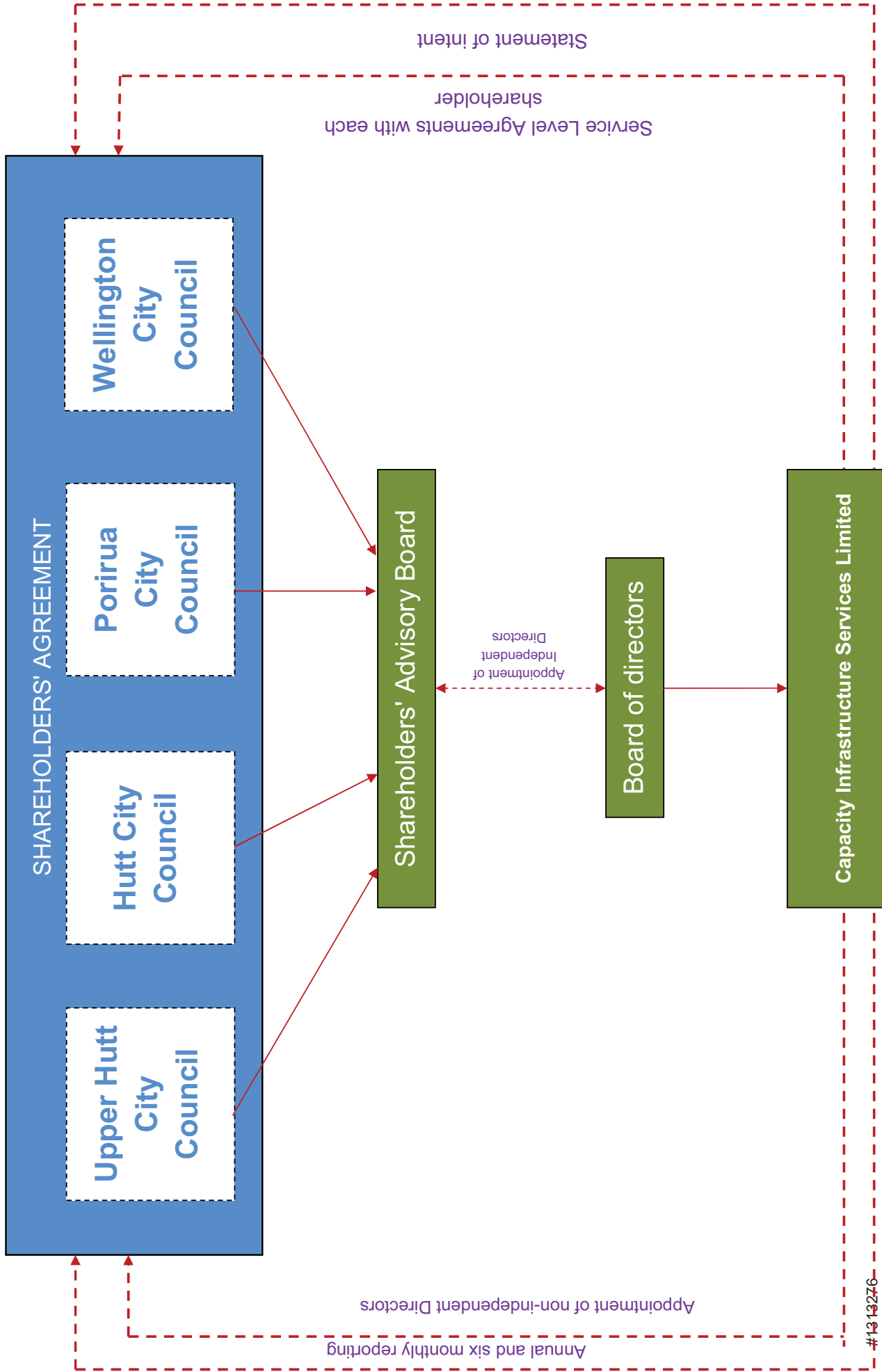
Make a submission

Submissions on this proposal may be made during the period to [xxx 2014] . The final date for making a submission is [xxx 2014]

To make a submission you can:

- Use the submission form on page 13 of the draft Annual Plan 2014/15 Summary
- Send an online submission form via our website www.gw.govt.nz/have-your-say
- Write a letter to us at:

Greater Wellington Regional Council
Water proposal
Freepost 3156
P O Box 11646
Wellington 6142



Annual and six monthly reporting

Appointment of non-independent Directors

#1313276

Service Level Agreements with each shareholder

Statement of intent

Appointment of Independent Directors

SHAREHOLDERS' AGREEMENT

Wellington City Council

Porirua City Council

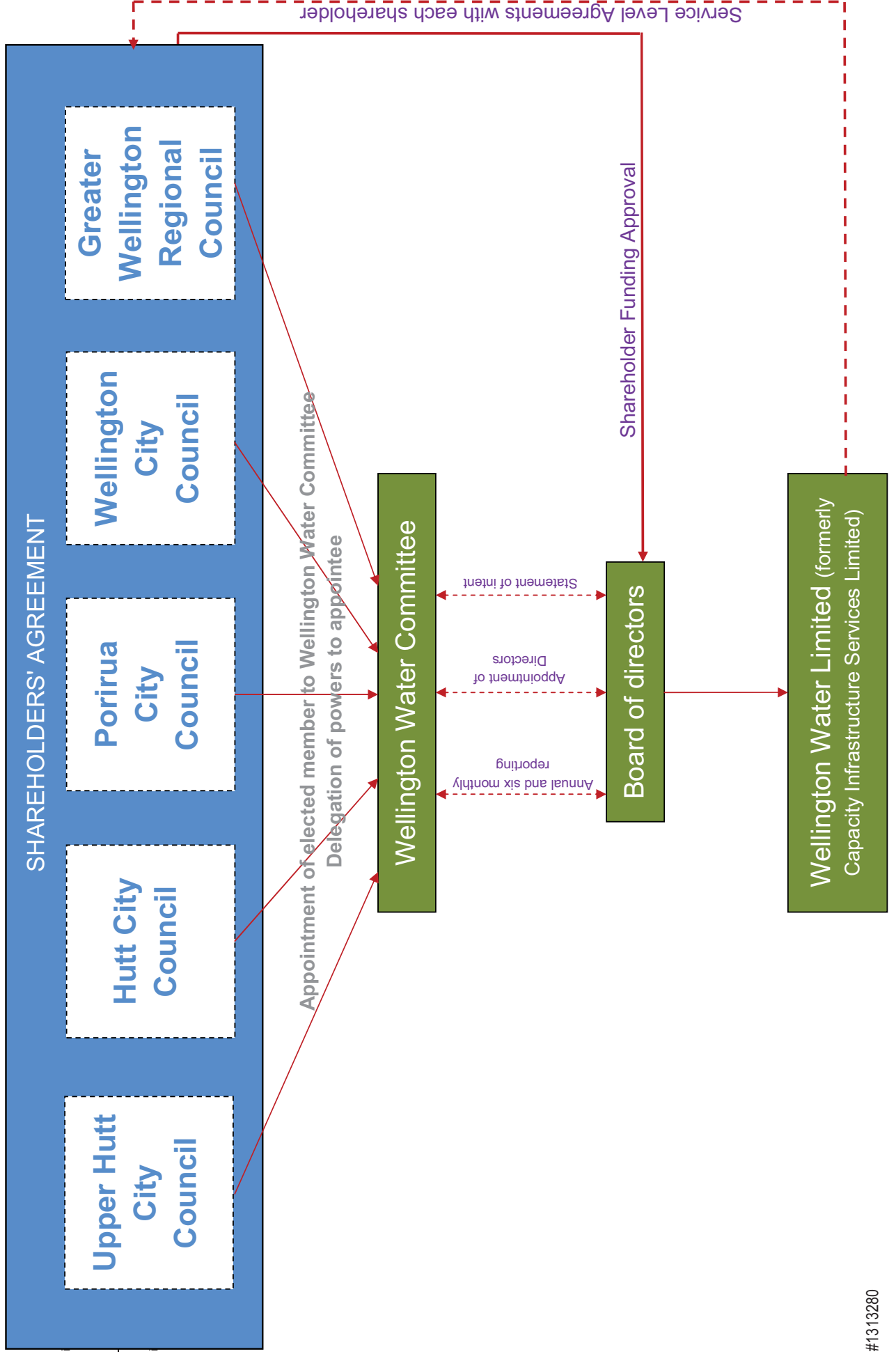
Hutt City Council

Upper Hutt City Council

Shareholders' Advisory Board

Board of directors

Capacity Infrastructure Services Limited



Regionalising Water Services

Discussion paper
December 2013



The Chief Executives
Greater Wellington Regional Council
Hutt City Council
Porirua City Council
Upper Hutt City Council
Wellington City Council

16 December 2013

Gentlemen

This discussion paper has been prepared to present options for amalgamating delivery of water services in the Wellington Region. It has been prepared in accordance with our engagement letter and should be read in conjunction with the important notice in Appendix A.

The case for change is primarily a function of qualitative benefits that will lead to direct and indirect financial benefits. These benefits will arise over the medium to long term, reflecting the long lived nature of the assets and the long term implications of decisions and actions today. The fact that the four retail water networks in the region are now being managed jointly is evidence that these long term benefits are worth pursuing.

The recommendation in this paper is that the bulk water supply business is amalgamated with the retail businesses within a company form. A new company could be formed or Capacity could be used. Using Capacity has the benefit of not disrupting current contractual arrangements. A new company could be used. There will be administrative issues to deal with but these are not insurmountable.

The other key recommendation is that the Councils form a governance group to exercise their shareholder rights and discharge their obligations in a coordinated and perhaps publicly transparent manner. This could be a committee of some form (a joint committee or a committee of the Greater Wellington Regional Council) or a "contractual form", for example the shareholders' advisory group under the existing Capacity shareholders' agreement. We would expect that this group would have the similar membership and consistent functions regardless of how it is constituted.

Please do not hesitate to contact us if you require further information or have any questions.

Bruce Wattie

Bruce Wattie
Partner
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Regionalising Water Services
pwc

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Context

Integrated management of water operations

The issue

The region's potable water network is not managed on a regional basis

- Ownership of potable water assets is distributed among the region's councils. But the potable water collection and distribution system is one large physically integrated network
- The form of the network reflects geography and the location of supply and demand. The allocation of the assets among the councils reflects historical boundaries, among other things
- The region's "retail" water assets are now all being managed by Capacity
 - PCC has entered into a service level agreement with Capacity
 - PCC and UHCC have joined HCC and WCC as shareholders in Capacity
- The missing component to deliver regional management of water services is GWRC's bulk (wholesale) network
- GWRC out-sources lab testing and certain physical works (in particular new build developments). Most asset management functions are undertaken in-house

What level of integration is envisaged?

Management of services and assets on behalf of GWRC (the Council)

- The model of integration will involve the amalgamation of the operation, maintenance and management of assets
- The Council will continue to own the bulk water network assets
 - Ancillary assets such as motor vehicles might be transferred
- Existing funding arrangements for the bulk water services will remain in place
 - The Council will continue to collect the bulk water levy from the four city councils
 - The component of the levy used to fund operating, maintenance and management of the bulk water assets will be paid to the regional water business rather than expended directly by the Council
 - Capital expenditure will be managed by the regional water business on behalf of the Council
- The Council will determine the standard of service to be provided by the regional water business. This will be incorporated into a “service level agreement”
 - The regional water business will be a service provider to the Council, delivering services under contractual terms

Why is integrated management of the water operations worth pursuing?

- The 2011 Region Wide Governance Review noted the opportunity to:
 - Develop a coherent regional strategy for the future direction of the Three Waters.
 - Consider the case for integrating water and wastewater delivery regionally.
- The concept of water regionalisation is not new:
 - Considered as part of the local government reorganisation in the late 1980s
 - The subject of a major study undertaken in 1997
 - Capacity was the product of the post 1997 process
- The case for incorporating GWRC's bulk water services into a regional water entity is not a consequence of any urgent need to make a change:
 - There is no immediate imperative for changing the way water services are delivered
 - The status quo could continue
- Regionalisation is about enhancing performance rather than fixing a problem

Why is integrated management of the water operations worth pursuing?

- There will be a range of benefits from full regionalisation:
 - Co-ordination of supply, transmission and distribution:
 - Coordinated approach to capital projects
 - Common assets specifications
 - Common asset management to optimise water quality and service etc.
 - Removing duplicated costs
 - Duplicated costs are primarily people related and other variable administration costs
 - But removing duplicated costs is unlikely to be the key driver of change
 - Removing duplicated costs assumes:
 - There are similar functions being carried out within the amalgamating entities
 - The duplication can be removed by absorbing costs within existing resources

Why is integrated management of the water operations worth pursuing?

- Economies of scale
 - Important but not all scale benefits are easily quantifiable and some will arise over the long term.
 - Scale benefits will include:
 - > Critical mass of expertise
 - > Critical mass of resource
 - > Purchasing benefits
- Best practice
 - Opportunity to extract good work practices and systems from the individual operations and apply them across all of the networks

Why is integrated management of the water operations worth pursuing?

- Efficiency benefits over and above the status quo can be expected in terms of:
 - Close co-ordination of demand analysis and management for the retail and bulk water systems
 - Network planning, development and management
 - Integration of maintenance cycles.
- There will be financial benefits that will flow from the qualitative benefits over the medium to long term:
 - We suggest that the direct short term savings in amalgamating the GWRC bulk water services with the retail services are unlikely to be compelling in themselves (not least because of the overhead restructuring the Council will have to undertake).
 - Savings in operating, maintaining and developing the networks or providing enhanced service given current costs are likely to accrue over the longer term.

Achieving integration

What is required – form of the water entity

What practical steps are required to achieve integration?

An entity to “house” the regional water business and an acceptable governance arrangement

- The regional water business needs a legal form to transact its business. It needs to:
 - Employ personnel
 - Engage consultants
 - Enter into contracts for capital works and maintenance
 - Enter into service level agreements with its council customers
- The entity will require a governance structure that:
 - Provides all councils with the appropriate level of oversight given their
 - Stewardship responsibilities for the investment (historical and future) in their networks
 - Statutory obligations to supply potable water and provide waste water and storm water services
 - Is effective and efficient for the water entity
 - Is aligned with and reinforces the multiple roles of the councils
 - Recognises and respects the distinction between governance and management

Options for the water entity

Three common structures for council activities

<i>Public Entity</i>	<i>Company</i>	<i>Trust</i>
Part of a council. Operated as a business unit. Not a separate legal entity but can enter into contracts	A separate legal entity from its owners (shareholders)	Legal title of property passed to a trustee(s). Can enter into contracts
No limitation on liability for council "owner"	Shareholder's liability limited to contributed capital	The trustee is liable for the obligations of the trust.
Funded by rates, charges to customers and/or debt	Able to raise debt or equity capital	Able to raise debt but limited ability to raise equity
Other Councils will not have a direct ownership interest in the Water Business. "Ownership" of water business not freely tradable. Accountability to council that "owns" business unit	Able to differentiate rights of different shareholders. Shareholders able to sell part or all of their interest in the Company. But ownership changes can be regulated by the shareholders	Beneficiaries are not able to readily exit the trust and do not necessarily have direct control over the assets of the trust
Governance exercised through council management structure through to Councillors	Company governed by a board of directors. Have a duty to act in good faith and in best interests of the company. But a director may, if expressly permitted to do so by the constitution, act in a manner which is in the best interests of a shareholder, even though it may not be in the best interests of the company	Governed by appointed trustees. Must exercise the powers of a trustee in the best interests of all present and future beneficiaries of the trust. Councils can appoint trustees but are unlikely to have direct influence over the trust
Local Government Act requirements will apply. Likely to have public service as an important objective but can also have operating in a business-like manner as an important driver of performance	Must comply with the Companies Act 1993 Operating in a business-like manner likely to be a primary objective	Must comply with the Trustee Act Trustee Act has a number of requirements that trustees must have regard to when investing or managing interests under their control
Tax efficient	Tax treatment: <ul style="list-style-type: none"> • Assessable income taxed at rate of 28% • No flow through of tax losses to shareholders 	Tax treatment: <ul style="list-style-type: none"> • Income not distributed within 6 months of balance date is taxed at Trustee level (33%) • No flow through of tax losses to beneficiaries; • NZ resident beneficiary income taxed at marginal tax rate.

Options for the water entity

- Council business unit provides direct accountability to Councillors and the public
- But:
 - Cost effective management and delivery of water services requires a business-like approach. Doesn't mean profit maximisation but it does mean applying business disciplines to the relationships with all stakeholders. Also means a business-like approach to governance
 - Debatable whether a council business unit is the best form to achieve a business-like approach
 - A council business unit will not allow multiple Councils to have an ownership interest in the Water Business.
- A company will allow all Councils to have an ownership interest
 - The ownership stake (shares) is legally defined
 - Conditions can be imposed on transfers of shares – can be structured to ensure that the company and its operations will remain in public ownership
 - Identified and separate ownership interests will allow clear recognition that each council has a stake in the water entity
- A company form is conducive to clear and transparent governance and accountability and is an effective form for achieving a business like focus
- A company has a different accountability structure to a council business unit. Doesn't mean accountability can't be transparent and effective
- The level and effectiveness of the accountability of a company is controlled by the councils, given that they will
 - Own it
 - Determine how its board is appointed
 - Set the overarching financial performance standards through the statement of intent
 - Determine the monitoring regime
 - Perhaps most importantly, determine the service outcomes they want from the company and monitor the company's performance in achieving the required outcomes
- A disadvantage of a trust is that operations and assets transferred to the trust will be "alienated" from the Councils.
- The Councils can appoint trustees but the trustees are required by law to consider the position of all beneficiaries of the trust in the context of the trust deed
- In essence, a trust will be less flexible than a company and council business unit in terms of control

Capacity as an option for the water business

- If a company form is acceptable, there are at least two options:
 - Establish a new company
 - Use Capacity
- Establishing a new company (“NewCo”) would/could involve:
 - GWRC subscribing for shares in exchange for some combination of ancillary assets to be transferred to NewCo and cash
 - Capacity transferring its assets, contracts and business to NewCo in return for shares or cash
 - Capacity being liquidated and distributing the NewCo shares or cash to the Capacity shareholders. If it is a cash transaction then HCC, PCC, UHCC and WCC will have to subscribe for shares in NewCo
 - Establishing a new constitution and shareholders agreement
 - GWRC agreeing to and entering into a service level agreement with NewCo (will be required under any option)

Capacity as an option for the water business

- Using Capacity would involve:
 - GWRC undertaking due diligence on Capacity
 - Sufficient to ensure there are no undue risks to GWRC in investing in Capacity
 - GWRC agreeing to the constitution and participating in the shareholders agreement
 - GWRC subscribing for shares in exchange for some combination of ancillary assets to be transferred to NewCo and cash – whether there will need to be a wider change to the capital structure will need to be determined
 - GWRC agreeing to and entering into a service level agreement (will be required under any option)
- The direct technical/administrative costs of setting up a new company to house the regional water business will likely cost more than using Capacity
- Capacity exists, has systems in place and is party to supplier contracts, has a workforce etc.

Changes to Capacity's business model

The changes have moved Capacity closer to being a regional water "business"

- There have been important changes to Capacity's ownership, governance and service level agreements recently
- This has moved the Capacity closer to being a business with an appropriate level of decision making autonomy, although it still subject to some constraints
- Appendix B provides a summary of Capacity's:
 - Shares and shareholding structure
 - Constitution
 - Shareholders agreement
 - Service level agreement

Achieving integration

What is required – governance arrangements

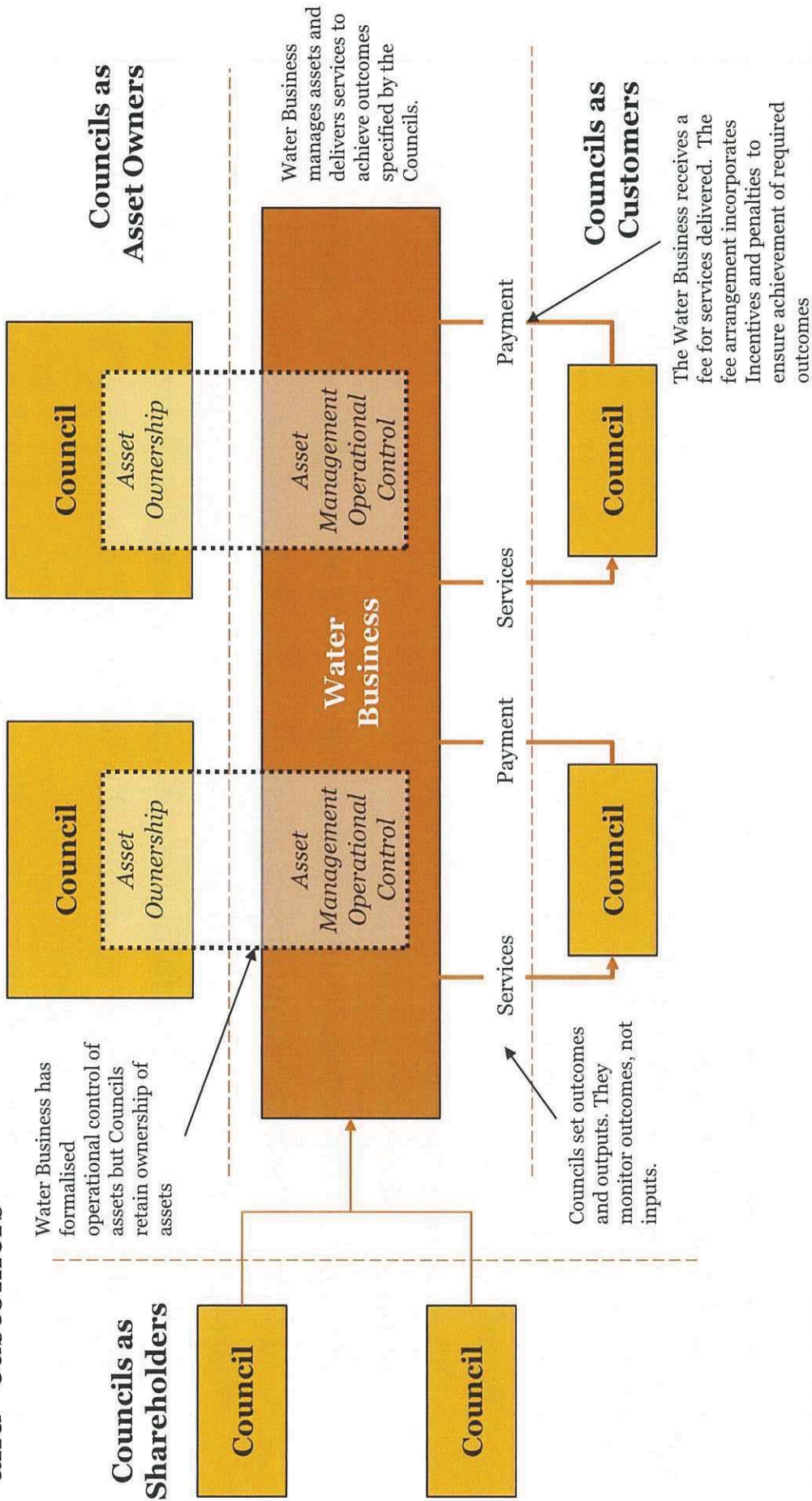
Governance arrangements

What governance arrangements for the water entity will best meet the Councils requirements?

- The existing governance arrangements for Capacity are:
 - Board of directors:
 - The council shareholders are entitled to appoint one director each and jointly appoint independent directors
 - Minimum of 4 and maximum of 8 directors (can be varied by Special Resolution)
 - Must be at least as many independent directors as non-independent directors
 - Shareholder Advisory Group established under the shareholders' agreement to:
 - Assist the shareholders fulfil their obligations under the Shareholders' Agreement
 - Coordinate shareholder accountability and assurance activities to reduce the workload for the Company
- These governance arrangements reflect the ownership relationship between the councils and Capacity

Council relationships with the water business

Three relationships with the water entity: asset (network) owners, shareholders and “customers”



Governance arrangements

- The most critical relationship is the customer (service level agreement) relationship
- The Councils specify the quality of service through the standards and KPIs in the service level agreements (SLA)
- The SLA also embodies the agreed work programme – this is part of the mechanism that ensures that assets are maintained to the standard set out in the agreed asset management plan
- Monitoring the achievement of the outcomes required under the SLAs is a critical function that each council will undertake individually in their role as customers of the water business
- The shareholder relationship is focussed on the councils exercising their shareholder rights and discharging their shareholder obligations under the constitution
- If the Councils exercise their rights as customers through the SLAs, the key governance issue to address is how best to structure the shareholder governance arrangements

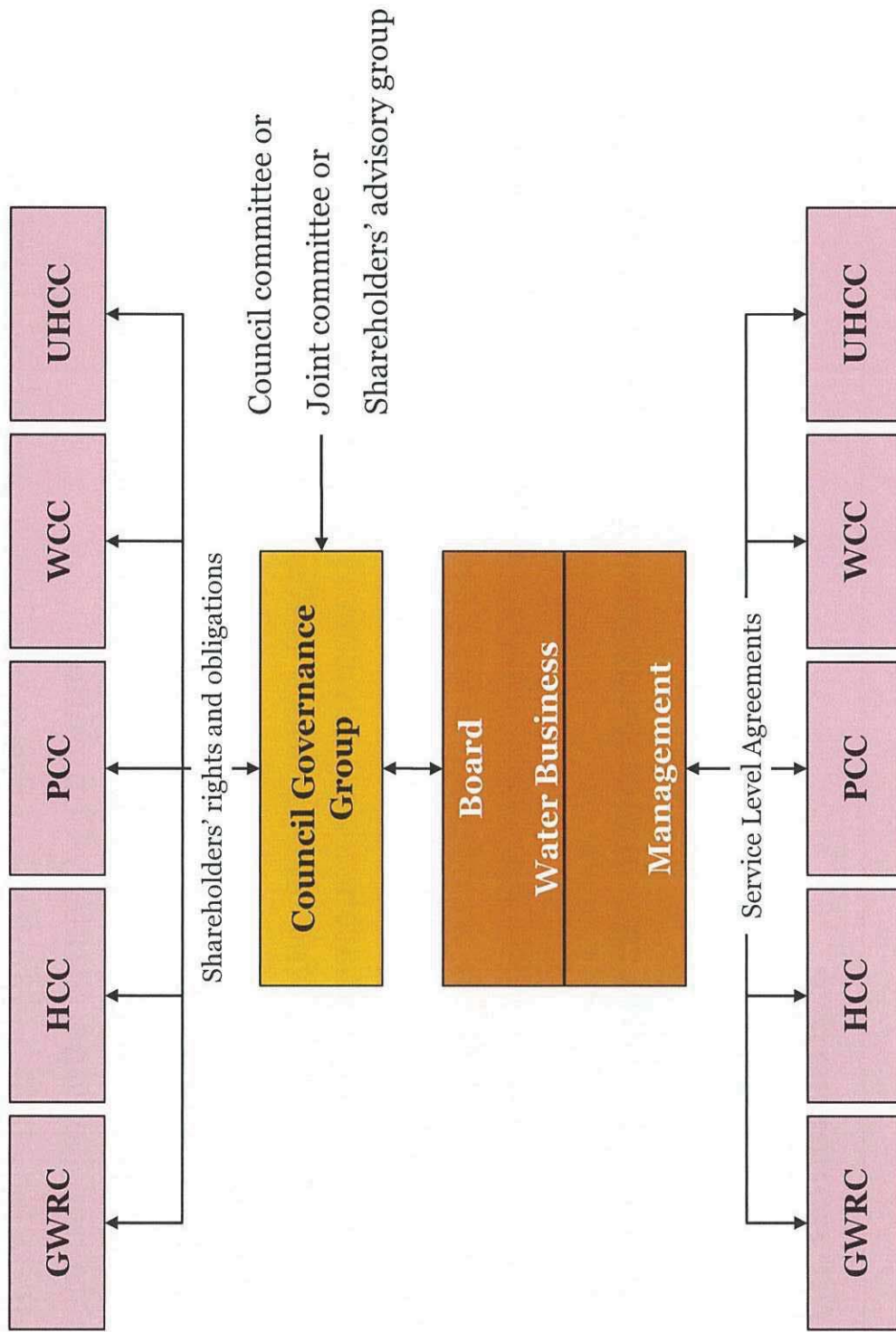
Governance arrangements

- Two high level approaches to exercising shareholder rights:
 - The Council's act individually and do not formally work in a coordinated manner to comment on the SOI and appoint directors etc.
 - The Councils come together under a formal arrangement to exercise their rights and discharge their obligations in a coordinated manner
- Both approaches are legitimate but the latter is recommended:
 - Encourages the shareholders to act regionally
 - Provides a body that can be the focus of public accountability
 - Creates an element of increased independence between the shareholders and the Board – more effective accountability
 - A single channel for communication between the shareholders and the Board
 - Does not preclude shareholders from disagreeing or exercising individual rights
 - Common practice for shareholders in a private company to govern the relationship between themselves and with the company through a formal arrangement (typically a shareholders' agreement)

Options for governance

- Formalisation of the council governance group arrangement will ensure legitimacy and effectiveness
 - An informal arrangement among shareholders, i.e. agree to work together, is likely to be ineffective over time
- Options for organising the council governance group:
 1. Use the concept of the Shareholders' Advisory Group included in Capacity's existing constitution i.e. the Shareholders' Advisory Group becomes the council governance group
 2. "Constitute" it formally as part of a council:
 - A committee of GWRC akin to the Regional Transport Committee and the Wellington Regional Strategy Committee
 3. Constitute its a joint committee of the councils not part of any particular council

Options for governance



Options for governance

- The governance options should not necessarily be distinguished by:
 - Their membership
 - The members can be the same whether the form used is the Shareholders' Advisory Group or a committee
 - The councils as shareholders can determine the membership
 - The role of the group
 - The role of the council governance group should be to exercise shareholder rights and discharge shareholder responsibilities regardless of the form:
 - > Discuss and agree the SOI
 - > Deal with director appointments
 - > Receive and monitor reports and papers from the directors on performance

Options for governance

The options can be distinguished by the basis on which they are constituted and their powers

	Shareholders advisory group	Committee of a council	Joint Committee
Legal basis	Shareholders' agreement	LGA	LGA – deemed to be a committee of each council
Decision making powers	Retained by each shareholder (council). The Shareholders' Advisory Group has no powers as an entity in its own right. It is a forum for the councils to discuss matters of mutual interest in their roles as shareholders	Retained by each member – powers of one council cannot be delegated to a committee of another council. Individual members of the committee can be delegated powers by the council they are representing but those powers will be exercised individually by those members, not by the committee in its own right	Can be delegated to the joint committee – joint committee can make decisions in its own right. The Councils can determine the extent of powers they want to delegate to the committee
Decision making process	Each shareholder to individually approve/agree	Each shareholder to individually approve/agree but these powers could be exercised at the committee level	Joint committee can approve/agree if delegated the appropriate powers to do so
<ul style="list-style-type: none"> Approval of SOI Appointment of directors 			

Options for governance

Assessment against criteria

	Shareholders advisory group	Committee of a council	Joint Committee
Encourages the shareholders to act regionally	✓	✓	✓✓ Depending on powers delegated to the committee
Provides a body that can be the focus of public accountability	✗	✓✓	✓✓
Encourages increased independence between the shareholders and the Board	✓	✓✓	✓✓
A single channel for communication between the shareholders and the Board	✓	Individual approval of SOI and directors, although voting on appointment of directors, for example, can occur as a meeting of the committee	✓ or ✓✓ Depends on powers delegated to the committee
Allows the Councils to individually agree to the SOI and director appointments	✓✓	✓	✓✓ or ✗ Depends on powers delegated to the committee

Options for governance

- The Shareholders Advisory Group is the least preferred option
- The difference between the two committee options is less distinct
 - A committee of a council cannot be delegated powers held by another council
 - Individual members of a committee of a council can hold delegated powers from the council they represent. But they will exercise these powers as individuals. The committee does not have the powers in its own right.
 - A joint committee can have delegated powers in its own right.
 - The councils can choose whether to delegate powers to the joint committee in its own right or delegate powers to the individual committee members
 - In the latter case the joint committee will be very similar to a committee of one council
- The choice of a committee of one council or a joint committee will be a function of factors other than purely analytical issues

Options for governance

- An administrative issue is how the group will be serviced – their will need to be a “secretariat” to organise meetings, produce correspondence with company etc.
- Arrangements will need to be made to service a Shareholder Advisory Group and a joint committee
 - A single council contracted to provide services
 - Rotated among councils
- A committee of the GWRC could be serviced by the GWRC

Possible financial benefits

Previous estimates of possible cost savings

Water regionalisation and financial benefits

- In 2011/12 a business case was prepared to support:
 - Changes to the Capacity business model to move it to a “water services” business
 - Porirua City Council becoming a Capacity customer
 - Porirua City and Upper Hutt City Councils becoming shareholders in Capacity
- The business case included a high level assessment by Capacity of the possible financial benefits of:
 - Moving to the new operating model
 - Inclusion of Porirua City Council as a customer
- Consideration was given to the possibility of GWRC joining Capacity but it was assumed, at that time, that if it were to occur it would be at a later date
- Nevertheless, the financial benefits assessment included a scenario of full integration
 - The water services of all Councils including GWRC being delivered by a single entity (Capacity)

Water regionalisation and financial benefits

- The financial benefits were based on information of varying detail and accuracy
- The quantified benefits were “informed estimates” rather than accurate forecasts
- The factors contributing to the financial benefits included:
 - Amalgamation of asset management systems
 - “Stranded costs”, being Council controlled overheads:
 - Overheads historically allocated by each council to its water services business unit
 - Transferring services to Capacity means that, in theory, the overheads could be “saved”
 - Operating cost savings through removing duplicated costs, achieving operational efficiencies etc.
 - Capital cost savings through streamlining, rationalising and consolidating capital works programmes

Water regionalisation and financial benefits

- The ability to remove (i.e. save) stranded overheads is by no means certain
- Conservative not to count this benefit, at least in the first instance
- Capacity's 2011/12 estimate of possible cost savings from GWRC amalgamating its water services with the four city councils was as follows (excl stranded overheads):

	\$000
Annual real cost savings	
Efficiencies from asset management integration	300
Rationalisation of vehicle use	8
Rationalisation of IT systems and software licences	164
Rationalisation of personnel costs	150
Operation and maintenance contract: extend the performance regime in Capacity's contract with its O&M service provider	75
Total	<u>697</u>

- The savings assumed full integration of the five councils' water services businesses

Appendix A

Important notice

Important notice

This paper has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose.

This paper is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this paper and/or any related information or explanation (together, the "Information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of the Councils. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

Business attached thereto.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this paper are based on information available as at the date of the paper.

We reserve the right, but will be under no obligation, to review or amend our paper, if any additional information, which was in existence on the date of this paper was not brought to our attention, or subsequently comes to light.

This paper is issued pursuant to the terms and conditions set out in our engagement letter and the Terms of

Appendix B

Recent changes to Capacity's ownership, governance and service level agreements

Changes to Capacity's business model

There have been important changes in the Capacity's business model and ownership structure

- Changes in Capacity's service level agreements with its customers and constitution and of a shareholders' agreement have been/are being implemented
- Prior to the recent changes, Capacity:
 - Managed contracts for operating and capital works on behalf of its Council customers – it did not have authority to enter into contracts in its own name
 - Was subject to scrutiny and monitoring by the Council customers to varying degrees
 - It terms of its own costs, operated, in effect, on a cost recovery basis
 - Had insignificant capital and operated to breakeven – it wasn't able to build up any significant retained earnings. Consequently, it has had little capital to invest in its business
 - Wasn't rewarded for efficient performance
 - Had two shareholders but three customers
 - Managed only part of the Wellington region's water operations (HCC, UHCC and WCC)
 - Managed each customers network on a separate, individual basis reflecting each customers requirements and standards
- As a consequence of the recent changes, Capacity:
 - Can enter into operating related contracts in its own name
 - Can enter into contracts for Capital Works up to specified values
 - Must deliver outputs against a range of key performance indicators
 - Will receive an agreed monthly amount for delivery of a work programme agreed with each Council. Capacity must manage its own costs and consultants within this cost.
 - It will be entitled to retain any surplus where actual costs are less than the monthly payment
 - [how are deficits funded]
 - Will receive an incentive payment if its performance is []
 - Has four customers and four shareholders
 - Now manages all of the "retail" water operations in the Wellington Region
 - Has received an injection of capital as a consequence of the shareholder changes
- Capacity's four shareholders have entered into a shareholders agreement and, under this agreement, have formed a Shareholders' Advisory Group to coordinate their shareholder activities and shareholder communications with the Company

Shareholdings and shareholder rights

- Recent important changes in Capacity's ownership, governance and operating framework:
 - PCC and UHCC have taken an ownership stake
 - Injection of capital
 - New constitution
 - Shareholders' agreement
 - New service level agreement
- New shareholdings are presented in the following table
- Two classes of shares
 - Class A: voting shares
 - Class B: distribution shares
- Class A
 - Appoint or remove a director or auditor
 - Adopt a constitution
 - Alter the company's constitution, if it has one
 - Approve a major transaction
 - Approve an amalgamation of the company under section 221
 - Put the company into liquidation
- Class B
 - Right to equal share in dividends.
 - Right to equal share in distributions of the surplus assets

	Class A		Class B		Class B
	No	%	No	%	\$000
HCC	150	25	100	25	200
PCC	150	25	60	15	120
UHCC	150	25	40	10	80
WCC	150	25	200	50	400
	600	100	400	100	800

Service level agreements

Important terms

- Services:
 - Planning and advice, including provision of AMPs
 - Inputs to Annual Plan and Long Term Plan to assist Councils determine annual and long term work to maintain, renew and as necessary expand their Networks
 - Manage all necessary operating and renewable work per the Annual Work Programme and the Annual and Long Term Plans
 - Manage all capital works per the Annual Work Programme and the Council's Annual and Long Term Plans
 - Strategic and policy advice to ensure that the Water Services are delivered by Council on an affordable and sustainable basis.
 - Manage the application of necessary resource consents
 - Performance measured against set of KPI with individual targets
- Contracts
 - Existing contracts for works or supply of assets in place at Commencement Date: Capacity acts as the principal's rep
 - Future contracts for operations and maintenance works or for supply of assets: Capacity will be the principal.
 - Future capital works projects: entered into in the name of the Council unless below stated thresholds (\$ value) in which case they can be in the name of Capacity
- Payments to Capacity
 - Standard Monthly Charge for providing the Management Services per the agreed annual work programme
 - Includes Capacity's costs and consultancy charges (operational and capital activities)
 - Capacity must manage within the Standard Monthly Charge – no "top-up" for overruns
 - Work outside annual work programme paid for separately
 - Councils must make payments to Capacity in accordance with specified timetable (minimises Capacity's working capital requirements).
 - Capacity entitled to an annual performance payment subject to meeting certain KPIs
- Contract expiry: 30 June 2021
- Capacity has no statutory powers other than under statute or expressly by the Councils in the contract or by separate formal delegation.
- Services to be provided in the best interests of the Council, recognising Council obligations to its various stakeholders.
- Capacity entitled to access Council's assets and infrastructure to provide the services but must safeguard the assets from damage, loss and destruction and keep the assets in good condition and repair (fair wear and tear excepted)
- Capacity and the Council relationship will be characterised by the "partnering" style of relationship.

Constitution

Important terms

- Shares cannot be issued or transferred to any person other than a Local Authority or a CCO
- New shares must be offered to existing shareholders pro rata to maintain the existing voting and/or distribution rights.
- Transfer of existing shares;
 - Requires a Special Resolution (75% majority)
 - Recipient or transferee must be a Local Authority or a CCO approved by all other shareholders
 - Directors may refuse to register a transfer if, among other things, they consider it would not be in the best interests of the Company
 - Directors must refuse to register a transfer if it has not been approved by Special Resolution or transferee not a Local Authority or a CCO
- CEOs are to be the representative of each Class A shareholder.
- Any resolution passed by Class A shareholders relating to the management of the Company is not binding on the Board if it is not specifically set out in the Constitution or Shareholders' Agreement.
- Quorum for shareholders' meeting is a majority of Class A shares
- Each Class A shareholder entitled to appoint one director
- Class A shareholders jointly appoint Independent Directors
- The Class A shareholder can remove its appointed director
- Directors:
 - Minimum: 4; Maximum : 8 (can be varied by Special Resolution)
 - Must be at least as many Independent Directors as non-Independent Directors
 - One vote per director at meetings. A resolution of the Board is passed if a majority of the votes cast on it are in favour of it
- Chairperson:
 - Must be one of the Independent Directors
 - Elected by all directors
 - Does not have a casting vote.
- The role of a Director is to assist the Company to meet its objectives and any other requirements in the Company's Statement of Intent.
- The business and affairs of the Company must be managed by, or under the direction of, the Board.
- The Board may authorise payment of dividends if it is satisfied that the Company will satisfy the solvency test.

Shareholders' Agreement

Important terms

- Establishes a Shareholders' Advisory Group (SAG) to:
 - Assist the shareholders fulfil their obligations under the Shareholders' Agreement
 - Coordinate shareholder accountability and assurance activities to reduce workload for the Company
- CEO's of each shareholder are the representatives on the SAG. Others may attend as observers from time to time.
- Meets not less than twice a year.
- Each shareholder has one vote
- SAG members appoint its chairman
- Role of SAG is to provide advice to shareholders and coordinate shareholder feedback to the Company. It particular it will:
 - Coordinate feedback on letters of expectations, draft and final SOI, quarterly papers
 - Coordinate feedback on Directors Fees
 - Discuss shareholder proposals to the board
 - Coordinate appointments to the Board
 - Coordinate views on changes to the Constitution or SA
- Discuss major transactions or other decisions requiring shareholder approval
- SAG not to agree or implement operational or management decisions that are the responsibility of the Company and its Board
- Each shareholder entitled to nominate independent director candidates
- SAG to discuss feedback on director nominations for independent directors
- Individual shareholders must each approve the appointment of an independent director
- Shareholders to
 - Act in a spirit of cooperation and collaboration, acting together to communicate effectively with the Company
 - Operate on a no surprises basis
- Shareholders' Agreement continues until:
 - One shareholder owns all shares
 - It is terminated.
- Matters requiring unanimous approval include: changes to the constitution, increases in share capital, buy backs, changes to rights, privileges or conditions attaching to shares, major transactions
- Matters requiring special resolution include: material change to the nature of the business, granting of an indemnity or guarantee, borrowing in excess of \$2 million other than in the ordinary course of business, new SLAs, acquiring a business

CITIES RESOLUTIONS – in principle agreement to the statement of proposal for GWRC to become a shareholder in Capacity

Changes to original resolutions are highlighted and underlined.

WELLINGTON CITY COUNCIL – GOVERNANCE, FINANCE AND PLANNING COMMITTEE RESOLUTION, 13 FEBRUARY 2013

Resolved:

THAT the Governance, Finance and Planning Committee:

1. *Receive the information.*
2. *Agree in principle to Greater Wellington Regional Council becoming a customer of, and shareholder in, Capacity Infrastructure Services Limited.*
3. *Agree in principle that this will result in changes to the board composition and the monitoring arrangements of this Council relating to Capacity Infrastructure Services Limited.*
4. *Delegate the responsibility to negotiate the terms of Regional Council joining Capacity Infrastructure Services Ltd as a customer and shareholder, insofar as they impact Wellington City Council, to the Chief Executive, ~~and~~ Chair of the Governance, Finance and Planning Committee, and Chair of the Environment Committee on behalf of Wellington City Council, subject to recommendation five.*
5. *Note that any final Wellington City Council agreement to Greater Wellington Regional Council becoming a shareholder in Capacity and any consequential changes to the governance of the company will be made by the Council.*
6. *Note that the Council will retain ownership of its three-waters network assets, and the funding and policy decisions relating to its network.*

HUTT CITY COUNCIL RESOLUTION, 26 FEBRUARY 2014

That council:

(i) agrees in principle to Greater Wellington Regional Council becoming a customer of, and shareholder in, Capacity Infrastructure Services Limited;

*(ii) agrees in principle that this will result in changes to the board composition and the monitoring arrangements of this Council relating to Capacity Infrastructure Services Limited; **and asks that the following issues be raised:***

- (a) **retaining elected members as directors of Capacity Infrastructure Services Limited at least as a transitional arrangement;***
- (b) **any joint oversight committee to be independent of any individual Council and not a committee of Greater Wellington Regional Council;***
- (c) **retaining the name 'Capacity Infrastructure Services Limited'; and***
- (d) **reviewing the company's constitution to increase the maximum terms of directors;***

(iii) delegates the responsibility to negotiate the terms of Greater Wellington Regional Council joining Capacity Infrastructure Services Ltd as a customer and shareholder, insofar as they impact Hutt City Council, to the Chief Executive and Mayor, on behalf of Hutt City Council, subject to part (v) below;

(iv) notes that any final Hutt City Council agreement to Greater Wellington Regional Council becoming a shareholder in Capacity and any consequential changes to the governance of the company will be made by the Council; and

(v) notes that Council will retain ownership of its three-waters network assets, and the funding and policy decisions relating to its network

(vi) requests officers to investigate the difference in savings forecast from the combined water entity.

UPPER HUTT CITY COUNCIL – POLICY COMMITTEE RESOLUTION, 19 FEBRUARY 2014

Resolved to recommend:

- 1. THAT the report be received.*
- 2. THAT Council agrees in principle to Greater Wellington Regional Council becoming a customer of, and shareholder in, Capacity Infrastructure Services Limited, subject to a satisfactory governance model.*
- 3. THAT Council agree in principle that this will result in changes to the board composition and the monitoring arrangements of this Council relating to Capacity Infrastructure Services Limited.*
- 4. THAT Council delegates the responsibility to negotiate the terms of Regional Council joining Capacity Infrastructure Services Ltd as a customer and shareholder, insofar as they impact Upper Hutt City Council, to the Chief Executive, on behalf of Upper Hutt City Council, subject to recommendation 5.*
- 5. THAT Council note that any final Upper Hutt City Council agreement to Greater Wellington Regional Council becoming a shareholder in Capacity and any consequential changes to the governance of the company will be made by the Council.*

6. THAT it is noted that the Council will retain ownership of its three-waters network assets, and the funding and policy decisions relating to its network.

PORIRUA CITY COUNCIL – TE KOMITI RESOLUTION, 27 FEBRUARY 2014

That te komiti recommend:

- *That the Council receive the information.*
- *That the Council agree in principle to Greater Wellington Regional Council becoming a customer of, and shareholder in, Capacity Infrastructure Services Limited.*
- *That the Council ~~agree~~ **note** in principle that this will result in changes to the Board composition and the monitoring arrangements of this Council, relating to Capacity Infrastructure Services Limited.*
- *That the Council delegate the responsibility to negotiate the terms of Regional Council joining Capacity Infrastructure Services Ltd as a customer and shareholder, insofar as they impact Porirua City Council, to the Chief Executive and the Elected Capacity Board Representative (the Mayor), on behalf of Porirua City Council, subject to recommendation five.*
- *That the Council note that any final Porirua City Council agreement to Greater Wellington Regional Council becoming a shareholder in Capacity and any consequential changes to the governance of the company will be made by the Council.*
- *That the Council note that the Council will retain ownership of its three-waters network assets, and the funding and policy decisions relating to its network.*