

Report	14.327
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Committee	Council
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Integrated delivery of Water Services

1. Purpose

The purpose of this report is to recommend that Greater Wellington Regional Council (GWRC) becomes a shareholder in Capacity Infrastructure Services Limited (Capacity), a council-controlled company. At the same time GWRC would transfer its bulk water supply function to Capacity and enter into agreements with Capacity for the provision of management services relating to bulk water services.

2. Background

In March 2014 Council considered Report 14.32 *Wellington Water – statement of proposal* to become a shareholder in a council-controlled organisation (**Attachment 1**). That report evaluated a number of options, including the status quo. Council decided to seek public input to the proposal. The four city councils, Wellington, Hutt, Upper Hutt and Porirua (Four Cities), which are the existing shareholders in Capacity, have or will be giving consideration to GWRC becoming a shareholder in the company.

3. Proposal

It is proposed that GWRC transfers its Water Group to Capacity, becomes a shareholder in Capacity and enters into agreements with Capacity for the provision of management services relating to bulk water supply. The proposal is outlined in greater detail in Attachment 1. There are some relatively minor changes to the proposal outlined in the earlier report and these are detailed in other parts of this report.

3.1 Public consultation

Public consultation was carried out using the special consultative procedure in conjunction with the GWRC's 2014/15 Annual Plan process. Twenty five submissions were received on the water integration proposal. These were considered by the Annual Plan 2014/15 Hearing Committee in conjunction with the Annual Plan hearings. The following is a section from the Hearing Committee's report to the GWRC:

The Committee also reviewed and considered written submissions and matters raised by oral submissions relating to the proposal to integrate the delivery of water services in the Wellington metropolitan area.

The Committee noted in particular the submission from Upper Hutt City Council that the proposed Water Committee should be a joint committee of the shareholding local authorities. The Committee also noted that each of the local authorities with a shareholding in Capacity Infrastructure Limited is currently considering their position in relation to the proposal, and that their position will be taken into account by Council when making a final decision on the proposal.

The Committee resolved to recommend to Council that the proposal should be agreed in principle, but that any further changes proposed by councils with a shareholding in Capacity Infrastructure Limited would need to be considered by the Council once these became known.

3.2 Position of the Four Cities' councils

Wellington City Council (WCC) considered the water integration proposal on 21 May 2014. WCC's Governance, Finance and Planning Committee passed a number of recommendations; the main decisions are summarised below:

- A joint committee of the five shareholding councils is established with one elected member from each council appointed to the committee.
- Capacity is renamed Wellington Public Water Services Limited or similar. (Referred to as Wellington Water in this report).
- The directors of Wellington Water are independent directors, to be appointed by each Council rather than by the Wellington Water Committee.
- A final decision will be made once GWRC agrees in principle to the water integration.

Upper Hutt City Council (UHCC) considered a report on the water integration proposal at a Council meeting on 28 May 2014 and Porirua City Council (PCC) through its Te Komiti committee, at its meeting on 5 June 2014. Each of UHCC and PCC passed a number of resolutions very similar to those passed by WCC.

Hutt City Council (HCC) considered the water integration proposal at its Finance and Audit Committee meeting on 18 June 2014. The committee has made similar recommendations to those outlined above, except that it proposes that the existing company name be retained and recommends that its Council advances the argument to retain elected members as directors of the company and that the Chair of the joint committee should be Deputy Mayor Bassett as Capacity's longest serving director. These recommendations will be considered at HCC's Council meeting on 26 June 2014.

4. Governance

Attachment 2 shows the linkages between the councils and Capacity/Wellington Water.

4.1 Joint Committee

The terms of reference for the "Wellington Water Committee" are attached as **Attachment 3**.

GWRC originally consulted the public on a GWRC committee with one appointed representative from each shareholding council. The differences between this and a joint committee, as proposed by the shareholding councils, are slight. In practice, the purpose and functions of the committee would be the same, whether it is a joint committee or a committee of GWRC. However, a joint committee must be established by each Council to be represented on the Committee and the Committee's terms of reference and any subsequent change to the terms of reference must be resolved by each Council.

The Council is required to appoint its representative and an alternate to the Wellington Water Committee.

4.2 Constitution and company name

Capacity's constitution will be amended so it reflects the governance model resulting from the changes detailed in this report.

The draft constitution of Wellington Water Limited is attached as **Attachment 4** for Council's approval. The preference is to retain this name rather than the suggested "Wellington Public Water Services Limited". It is proposed that the company's name be approved by the Committee once it is established.

4.3 Shareholder Agreement

The Four Cities are signatories to an existing shareholder agreement. A new shareholder's agreement will be entered into, including GWRC as a party, to reflect the new structure. A shareholder advisory group is not required as its role is largely replaced by the joint committee.

The draft Shareholders Agreement pertaining to Wellington Water Limited is attached as **Attachment 5** for Council's approval.

4.4 Issuing of shares to GWRC

PricewaterhouseCoopers (PwC) carried out an analysis to determine the number of shares GWRC should be issued in Capacity. Their recommendation is 150 voting shares, the same number as held by each of the other councils. Either 75 or 80 equity shares are recommended. There is an option because the allocation methodology used when UHCC and PCC purchased shares is not easy to apply to GWRC's situation as a bulk water supplier. It is proposed to ask the existing shareholders in Capacity to approve the issue of 75 shares to GWRC at \$2,000 each – a \$150,000 investment.

4.5 Appointment of Directors

It is proposed that the directors of Wellington Water Limited will be appointed by the Wellington Water Committee rather than by each Council making the appointments. This provides an efficient mechanism for the exercise of this shareholder responsibility.

4.6 Approval by existing shareholders (Four Cities)

Subject to Council's approval of the proposal as amended, establishment of the Wellington Water Committee and adoption of the Committee's terms of reference, and agreement to the draft constitution of Wellington Water Limited and the Shareholder's agreement, these matters will be referred to the Four Cities for their consideration and action.

5. Financial

5.1 Funding the purchase of shares in Capacity

Shares will be paid for out of the Water Group's funds. PwC has noted the share value of \$2,000 is not fully supported by the current net asset backing in Capacity. Hence the shares contain an element of goodwill. The \$2,000 share price though is the same as paid by UHCC and PCC for their shares last year.

5.2 Asset transfers

It is not proposed to transfer any GWRC land or fixed assets (e.g. pipelines, reservoirs and water treatment plants) or plant items to Capacity. Most of the motor vehicles used for bulk water will continue to be used solely for this purpose. Provision will be made to replace fixed assets, plant, equipment and motor vehicles in the GWRC Annual Plans.

5.3 Stranded GWRC overheads

In the 2013/14 financial year there are GWRC corporate charges to the Water Group. These amount to \$2.1M and can be separated into two groups, namely services provided and corporate overheads.

5.4 Services provided

Services costing \$0.7M include Information Technology, Biodiversity, Parks and the regulatory group for resource consent applications and compliance costs. It is expected that most of these costs will continue as once the Water Group transfers to Capacity it will still need to purchase similar services to deliver bulk water. Service level agreements will be put in place to purchase these services from GWRC, at least for the next few years. Over time there may be rationalisation within Capacity and other ways may eventuate of providing some of the services.

5.5 GWRC Corporate Overheads

GWRC overheads costing \$1.4M include a share of all corporate functions, including Human Resources, Finance and Support, Democratic Services, Information Services, Communication and Planning functions, and the Chief Executive's Office. These are charged to the Water Group and recovered through the water levy.

These costs are an essential component of operating the GWRC and delivering all outcomes, including bulk water supply. The overhead charging methodology is being reviewed to ensure the overheads charged to the Water Group are equitable. Some overhead contributions may not continue into the future, but most will as these costs are part of the costs to manage the bulk water function and will remain within GWRC. For example, GWRC will still have to maintain the SAP financial and asset management system, GIS and other systems, pay all invoices, manage GST and legal processes and report on the bulk water system as the asset owner. Pending health and safety legislation will place new responsibilities on GWRC as the owner of the bulk water work places.

While mechanisms will evolve to reduce these overhead amounts over the next five years, many of them cannot be eliminated. These overhead costs and any remaining services costs that are not part of service level agreements will continue to be recovered through the water levy charged to the Four Cities.

Apportioning costs in this way ensures there will be no cost to the regional rates through transferring the Water Group to Capacity.

5.6 Capacity Overheads

The proposed funding model for Capacity allocates overhead costs to each council based on that council's proportion of the total work programme. All other costs, i.e. direct operating costs and costs related to council specific projects and work programmes, are billed to the councils.

GWRC's share of Capacity's overheads will be recovered through the water levy.

6. Staffing

There is an agreement in principle with Capacity to transfer the Water Group staff to Capacity on the same terms and conditions of employment and to recognise service as continuous. This means that staff will be transferred under the employment protection provisions of their employment agreements and no entitlement to redundancy compensation arises upon transfer. If an individual employee decides not to accept employment with Capacity, their termination is not treated as a redundancy but as a resignation.

7. Risks

7.1 General

A number of risks were outlined in Report 14.32 - these should be reviewed in parallel with this report. Once the Water Group moves to Capacity it would be difficult to reverse the process. Hence, the GWRC has to be satisfied that the company constitution, shareholder agreement and service level agreement with Capacity are adequate to ensure there is a very low risk of failure.

7.2 Legal due diligence

DLA Phillips Fox was asked to conduct a high level due diligence review of Capacity's current business to identify any material legal risks to GWRC in respect of its proposed investment in Capacity. Capacity's management responded to a list of detailed questions relating to the company's operations and management.

The responses to the due diligence questions indicated that Capacity is operating in accordance with good business practice and no major issues were identified beyond fairly routine matters.

Capacity's key agreements are with each of the Four Cities to provide management services in relation to water services. These agreements provide for annual work programmes and each Council has arrangements with Capacity regarding risks the company may incur in relation to the services it provides to that Council. If one or more of the Four Cities elected to pull out of the management arrangements this would impact on Capacity's business operations but, other than in exceptional circumstances or by agreement between the Shareholders, lengthy notice of any withdrawal is required.

Agreeing annual work programmes and budgets with each of the Four Cities, particularly in relation to services shared between Shareholders, is an area of risk for the company but procedures are built into the management services agreements to enable business to carry on until resolution is reached.

Capacity also faces risks in relation to its management and operation of water assets; for example, in relation to discharge consents. However, the company has in place contractual arrangements, insurance, policies and procedures to mitigate these risks.

7.3 Financial due diligence

PwC was asked to conduct a high level due diligence review of Capacity's current business to identify any material financial risks to GWRC in respect of its proposed investment in Capacity.

PwC's review of the historical financial information provided to it has not revealed issues of material concern. The business has in the past been relatively simple and tightly controlled by the customer shareholders in the sense that it has had very little financial flexibility to invest or spend outside of its predetermined revenue constraint. Of importance though are:

- The significant changes that the Company is implementing now in relation to the new Service Level Agreements and bedding down its relationship with Porirua City Council.
- The future changes it might have to implement to integrate Greater Wellington Regional Council's bulk water operations if Greater Wellington Regional Council becomes a customer and the additional staff expected to transfer from Wellington City Council.

The current and potential future changes will result in a very rapid and sizable expansion of the business and the need to integrate people from four different organisations. The challenges involved and the need for effective change management and tight financial control are self-evident.

A further important issue is that the Company has not been in the position in the past to be able to invest in changes to information technology systems and related processes to any great extent to rationalise and harmonise its interactions with the variety of asset and other systems operated by its council customers. How and when this required investment will be made is in part bound up with the development of shared services for information technology being investigated by some of the region's councils. However, notwithstanding how the changes are to be implemented, the investment will be required to assist Capacity enhance the efficiency of its operations and could well require the shareholders to inject additional capital into the Company in some form.

8. Next Steps

8.1 Schedule of outstanding work

Governance and company issues

Subject to the Council's approval of the recommendations contained in this report, a similar report will shortly be considered by each of the Four Cities. If the recommendations are adopted by all the parties, the following steps will be taken to implement the proposal:

1. Capacity's Board will authorise the issue of shares to GWRC with the unanimous approval of the Shareholders. Documentation to be drafted.
2. GWRC will consent to hold shares in Capacity. Documentation to be drafted.
3. Capacity's Board will adopt the revised constitution with the approval of the Shareholders. Documentation to be drafted.
4. Each of GWRC and the Four Cities will enter into the new Shareholders' Agreement.
5. Capacity will change its name to the name agreed by the Wellington Water Committee. The names Wellington Water Limited and Wellington Public Water Services Limited have both been reserved with the Companies Office for this purpose. Documentation to be drafted.
6. The Wellington Water Committee will approve the appointment or removal of Capacity's directors. Documentation to be drafted.
7. GWRC will enter into an agreement with Capacity recording the terms on which it transfers certain assets of its water group to Capacity and any transitional arrangements such as in relation to corporate services. Documentation to be drafted.

Management issues

There are a number of services provided to the Water Group by other GWRC departments, e.g. Biodiversity, Parks and Environmental monitoring. These services will continue following integration and Service Level Agreements are being prepared to formalise arrangements between GWRC and Capacity.

A management services agreement between GWRC and Capacity will be drafted, negotiated and entered into to record the terms on which Capacity will manage GWRC's bulk water assets. There is a standard format for Service Level Agreements between Capacity and the four existing shareholder councils. This is currently being reviewed by the Water Group to include a set of service levels for the bulk water function to be approved by GWRC.

The bulk water supply control network is intimately connected with the GWRC corporate ICT network and therefore moving Water Group staff on to the current Capacity network has to be worked through carefully. It may be preferable, in terms of cost, risk and long term economies that the merged entity (Wellington Water) is

provided with ICT services by GWRC. Deloitte has been engaged to investigate and report on the preferred option.

Following approval of the integration proposal the Water Group Annual Plan will need to be revised.

9. Decision making process and significance

The decisions being sought in this report have been assessed by officers as being 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 requiring the use of the special consultative procedure before a local authority may become a shareholder in a council controlled organisation. The required consultation has been completed.

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).

10. Recommendations

That the Council:

- 1. Notes that a proposal to combine water services across Wellington, Porirua and the Hutt Valley has been consulted on in accordance with the special consultative procedure as set out in the Local Government Act 2002.*
- 2. Notes that submissions received on the proposal were considered by the Annual Plan 2014/15 Hearing Committee, and that no changes to the proposal were recommended as an outcome of the Committee's deliberations.*
- 3. Notes that the proposal for the integrated delivery of water services has been considered by WCC, UHCC, PCC and HCC, and is being further considered by HCC on 26 June 2014.*

4. **Agrees** that it supports the integrated delivery of water services across Wellington, Porirua and the Hutt Valley.
5. **Approves** the proposal for the integrated delivery of water services as set out in the Statement of Proposal subject to the following modification as an outcome of the consideration of the proposal by WCC, UHCC, PCC and HCC:
 - That the Water Committee be a joint committee of the councils represented on the committee.
6. **Establishes** the Wellington Water Committee as a joint committee of Wellington Regional Council, Wellington City Council, Hutt City Council, Porirua City Council and Upper Hutt City Council.
7. **Adopts** the terms of reference for the Wellington Water Committee, as set in Attachment 3.
8. **Appoints** Cr ... as the Council's representative on the Wellington Water Committee and Cr ... as the Council's alternate representative on the Wellington Water Committee.
9. **Approves** the draft constitution of Wellington Water Limited.
10. **Approves** the draft Shareholders Agreement for the shareholders of Wellington Water Limited.
11. **Authorises** the Chief Executive to:
 - i. agree changes to the draft constitution of Wellington Water Limited and the draft Shareholders' Agreement for the shareholders of Wellington Water Limited which are of a minor nature;
 - ii. negotiate the terms of the documentation required to implement the proposal, including arrangements in relation to the transfer of the Water Group staff, and management services agreements; and
 - iii. execute documentation required to implement the proposal and to report these matters to Council for its information.

Report prepared by:

David Benham

Chief Executive

Attachments:

1. **Report 14.32 - Wellington Water: statement of proposal to become a shareholder in a council controlled organisation.**
2. **Decision matrix**
3. **Draft terms of reference for the Wellington Water Committee**
4. **Draft constitution of Wellington Water Limited**
5. **Draft Shareholders' Agreement relating to Wellington Water Limited**