Decision-Making in Relation to a CCO for Waters

A Report prepared for the Waipa District Council by:
Peter McKinlay
Executive Director, McKinlay Douglas Ltd and research associate, Institute for Governance and Policy Studies, Victoria University of Wellington

McKinlay Douglas Ltd
PO Box 13125
Tauranga 3141
075794217
021614115

9/29/2015

Decision-Making in Relation to a CCO for Waters

Introduction

Waipa District Council (the Council) together with the Hamilton City Council and the Waikato District Council is considering the possibility of establishing a Council Controlled Organisation (CCO) to take over the ownership of assets and the management of services for potable water and wastewater within the three districts and to manage their storm water services.

This paper has been prepared for the Council by McKinlay Douglas Ltd (MDL). It is intended both to support an MDL facilitated workshop for the Council, and provide a resource for councillors on relevant research which may assist with the decision-making process.

Background

Extensive work has been carried out for the three councils evaluating potential efficiency gains and cost savings which could result from the formation of a CCO as a means of consolidating the provision of water services. This work has been undertaken largely within the context of section 17A of the Local Government Act 2002 which requires that a local authority:

> must review the cost-effectiveness of current arrangements for meeting the needs of communities within its district or region for good-quality local infrastructure, local public services, and performance of regulatory functions.

The reports so far received by the three councils, and specifically by the Council as a result of further work commissioned to address concerns raised by its elected members, all support the formation of a CCO. The analysis in all of those reports leads to the conclusion that the formation of a CCO will result in significant efficiencies and cost savings. The Council has been advised that it would need very strong grounds not to proceed with the formation of a CCO in the light of both the technical advice and the legal advice it has received.

The Council's chief executive has advised MDL that "Waipa elected members are concerned that the reports upon which it has relied up until now might contain an element of bias in favour of CCOs…. Whilst the accounting, engineering and legal disciplines are strongly in favour of a CCO, the Council remains concerned about the parent organisation losing economies of scope and scale and retaining sufficient ability to influence decisions in favour of its ratepayers."

From the material which MDL has considered in the lead up to the Council's decision to commission this paper and the associated workshop, the principal matters of concern for elected members include:

- Whether the process so far followed in assessing the arguments for and against the establishment of the proposed three-Council CCO has an inherent bias in favour of the CCO option?

- The extent to which and how the Council would be able to ensure that the establishment of the CCO did not restrict its ability to achieve other and significant activities including, for example, economic development and environmental management.

- The impact on the Council's on-going strategic capacity. This follows from the reality that the Council's three waters operation represents a significant part of its total activity such that the transfer to the CCO would result in a significant downsizing of council staff and potentially of council strategic capability.

MDL's proposal for the Council is that the workshop and paper should cover three separate but interrelated matters:

- An overview of emerging practice in decision-making by councils on their 'provision' and 'production' decisions, that is, decisions respectively about what services a council should ensure are available for its communities and how those services might best be produced. This includes a shift towards what is known as strategic commissioning. The point of commencing with this overview is to emphasise from a public policy perspective the strategic nature of the decision confronting Council and the importance of considering not just the 'stand-alone' cost and efficiency rationale but also the interaction with other council services, and the impact on the ability of the council to meet the changing needs of its communities over time, especially given the very uncertain and dynamic environment in which local government will be functioning over the next decade or two.

- The pros and cons of a CCO structure looking in particular at governance and accountability issues including the ability of councils to ensure CCOs pay proper regard to the non-commercial objectives of the communities they serve.

- How the Council could approach ensuring that it is able to retain discretion in respect of areas of importance to the Council and its communities. This will include discussing the role of shareholders' agreements, something which has not been considered in consultancy reports so far which have relied instead on the use of statements of intent.

Before moving on to discuss the three matters which this paper addresses, there are a couple of preliminary observations MDL would make about the legislation under which the decision will be made.

First, there is now a potential conflict between the two arms of the purpose section of the Local Government Act, section 10. The purpose of enabling local democratic decision-making by and on behalf of communities may not always support the purpose of meeting the current and future needs of communities in a way which is most cost-effective for households and businesses. Communities will often have preferences which do not support a least cost approach as evidenced recently by the overwhelming rejection of the Hawke's Bay amalgamation proposal despite evidence that it would result in reduced costs (the rejection may of course have reflected some scepticism about the analysis). MDL notes that the purpose of enabling local democratic decision-making by and on behalf of communities does not appear to have been considered by those reports the Council has received which argue it would need strong grounds in order to decide not to proceed with the proposed CCO.

The second observation concerns the wording of section 17A itself which appears to be written to drive councils towards selecting the least cost option for the delivery of services, especially major services. If a CCO appears to be the least cost option, it appears to MDL councils will need to be very careful about how they proceed. We make this comment because the establishment of a CCO requires the use of the special consultative procedure. The principles of consultation set out in section 82 of the act include "that the views presented to the local authority should be received by the local authority with an open mind and should be given by the local authority, in making a decision, due consideration." Although it is not within our competence to provide legal advice, we would suggest that any decision by a council to approve in principle the adoption of a waters CCO be subject to legal advice that this would not compromise its statutory obligations regarding consultation. It may be that the rather than a decision in principle to proceed with the formation of a CCO, the Council should be considering whether, as a matter of principle, the formation of the proposed CCO should be put out for public consultation thus making it clearer that the Council would be in a position to consider submissions with an open mind.

This paper addresses each of the three matters outlined above in turn.

Emerging Practice in Decision-Making

As already noted, the proposal which the Council is considering for the establishment of the waters CCO has been developed and presented for decision-making purposes primarily within the service review framework of section 17A of the Local Government Act.

Consistent with this approach, the report's comments regarding the impact on councils is focused on "other core activities" and is expressed as:

> **Council viability**. The removal of water and wastewater activities would be a major change for Councils in terms of assets, debt and staffing. It has been suggested that the viability of small councils may be threatened. However, water services benefit from economies of scale which even larger councils like HCC can never truly achieve. In addition, it can be argued that the reallocation of water services to a jointly owned water utility will allow councils to better focus their resources and efforts on their other core activities. Such activities may not offer the same economies of scale as water and benefit strongly from local input and decision making.

This is highlighting what the Council itself has separately identified. The CCO decision is not just about the three waters in isolation, but the future role and capability of the Council in dealing with all of the other matters it will still remain responsible for.

There are basically two ways the Council could approach this. One is as the consultants' report implies, how best to manage downsizing and refocusing on remaining core activities.

The other is a rethink of how the Council approaches its role in relation to the communities it serves and whether it puts primary emphasis on its service delivery functions (not uncommon in local government in New Zealand) or on its role in shaping the future of its communities. This would extend its focus from being primarily on service delivery, to what part it should play in coping with a number of the major trends likely to impact on its communities over the next decade or two. These include demographic change, globalisation, the disruptive impact of technology on employment and fiscal austerity.

Treating the CCO decision as including a rethink of the Council's role would not necessarily mean arriving at any different conclusion about the merits of the CCO. What it would do, among other things, is highlight for the Council the need to think about what should be in place as part of the CCO arrangements to ensure that a broader role in relation to its communities was not compromised in any way.

This would reflect much of what is happening with local government in other jurisdictions. It's now quite common for councils elsewhere to draw quite a sharp distinction between 'provision' and 'production'. Provision is the set of decisions about what services to what standards a council should ensure are available for its communities. 'Production' is treated as the quite separate decision about who is best placed to produce the service. A somewhat extreme example of where this can lead is the group of mainly California councils which link together in what is known as the contract cities organisation (www.contractcities.org).

Most of these councils have a relatively small population base and lack the scale to be cost effective service producers. They are, however, very committed to preserving their independent local democratic role. They manage by contracting out their services, some to other councils, some to NGOs, some to the private sector.

This is made possible by the existence of a very deep and long established market in the United States for local government services - it is typical for councils to contract out as much as 30% or 40% of all services. The depth of the market and the understanding which different parties have of the nuances of contracting in an environment of democratic accountability contributes to both the effectiveness and the acceptability of contracting out.

The New Zealand situation is different and this needs to be recognised. There is no equivalent market in local government services, and still relatively limited experience with arms' length entities such as CCOs. This makes it essential to ensure contracting out or arms length arrangements are carefully designed to encourage all parties to recognise and respect not just the efficiency objectives, but the importance of democratic accountability and of ensuring councils themselves retain access to the feedback loops they need in order to take decisions not just in respect of outsourced services, but in respect of other services which may need to interact with or are influenced by contracted out services.

In New Zealand debate about role and function of local government in recent years has been very much focused on the improvement of efficiency through means such as amalgamation and the redesign of service delivery. This has tended to reinforce the role of councils as service deliverers (even shared services discussions usually assume that services will still be delivered by a council or councils). In comparison, other jurisdictions such as much of Australia, and the United Kingdom, have been more focused on the role which local government can play in working with its communities to help achieve the best outcomes in a rapidly changing environment, something which is likely to be the new norm in New Zealand as well as other jurisdictions.

In considering this, we turn first to the way thinking has been evolving in Australia. In 2007 the Queensland local government reform commission delivered its report on the proposed restructuring of local government in Queensland. Its reasoning included:

> The challenges confronting Queensland in the coming decades require governments of all levels to be high capacity organisations with the requisite knowledge, creativity and innovation to enable them to manage complex change (P7).
>
> And
>
> The reform agenda for local government is focussed on strengthening the capacity of councillors to operate at a strategic level by developing policies that benefit the whole of their area while accommodating the distinctive needs of the various communities within their jurisdiction (P 57).

In NSW the NSW Independent Local Government Review Panel commenced its first public discussion paper[1] with:

> Local government in New South Wales must change. The future is challenging but also full of potential. Local councils must embrace the challenges and realise the potential. They can be catalysts for improvement across the whole public sector. They can demonstrate how to tackle complex problems by harnessing the skills and resources of communities, and how effective place-shaping can boost the State's economy and enhance people's quality of life.

In its second discussion paper[2], setting out its proposals for change, it observed:

> As part of this systems approach, the Panel aims to enhance the capacity of councils individually and local government collectively to play a much stronger role in the broader system of government. In its 2007 report the Queensland Local Government Reform Commission argued that the challenges facing the State "… require governments of all levels to be high capacity organisations with the requisite knowledge, creativity and innovation to enable them to manage complex change…."
>
> The concept of 'strategic capacity' highlights this aspect of reform: the need for councils or groups of councils to have the ability to respond to the diverse and changing needs of different communities, and to take on new functions or deliver improved services in order to meet those needs. This implies a move to larger, more robust organisations that can generate increased resources through economies of scale and scope and then 'plough back' efficiency gains into benefits for their communities.

It is not necessary to agree with the conclusion that strategic capacity necessarily implies larger councils (amalgamation) to recognise that enhanced strategic capacity is perhaps the single most critical issue confronting local government in an increasingly complex environment. It's a capacity which includes both the ability and means to develop a really informed understanding of the different needs and preferences of a council's communities (geographic and otherwise) and to develop effective strategies for responding to the increasingly complex challenges which communities will face over the next decade or two.

In England the emphasis on developing the strategic role of local government reflects the broader range of responsibility of local government and the increasing

---

[1] Better, Stronger Local Government: The Case for Sustainable Change, P3, available at: http://www.localgovernmentreview.nsw.gov.au/documents/LGR/Stage%20One%20Consultation%20-%20The%20Case%20for%20Change.pdf

[2] Future Directions for NSW Local Government: Twenty Essential Steps, p8, available at:

focus on the part of central government initially on greater devolution and more recently on financial cutbacks. The Englishexperience is nonetheless very relevant for New Zealand local government, especially if (when) councils are required or decide to undertake a more significant leadership role in working across the full range of needs which are expressed at a community level.

One important response in England has been an on-going shift to what is known as 'strategic commissioning' which commenced before the recent major cutbacks but gained momentum as they were implemented. A 2011 report[3] from the English local government think tank, Localis, describes strategic commissioning as "the process of identifying needs within the population and developing policy direction/service models and the market to meet those needs in the most appropriate and cost effective way".

It goes on to say "In this report, we take the position that strategic commissioning should be 'provider neutral', focusing on local need and the best pathways to deliver that need. The public, after all, prioritise an effective public service above and beyond who provides that service."

An illustration of how the idea of commissioning is actually understood within a council comes from the South Gloucestershire Council's procurement and commissioning strategy 2014-2018[4]

> The word commissioning means different things to different people. It is therefore important to state clearly the definition of commissioning as used within this strategy and accepted throughout South Gloucestershire. In South Gloucestershire it is considered that commissioning is the process to meet local need which involves both specifying and securing good quality provision. Priorities are those which are needed to improve the outcomes for users and are fully informed by their views. The provision secured must be cost effective and provide value for money. Commissioning includes monitoring and evaluating services provided in order to ascertain their impact on improvement, and applies to all services within South Gloucestershire whether provided by the Local Authority, Health Service, Police, Schools, and the private or voluntary sector.

Another example comes from the London Borough of Barnet which now describes itself as the commissioning Council[5]. The Council's leader describes the change as "from an organisation that provides the majority of services directly, to a 'Commissioning Council' which commissions a range of internal and external providers in the market to achieve the best value and the best outcomes for residents."

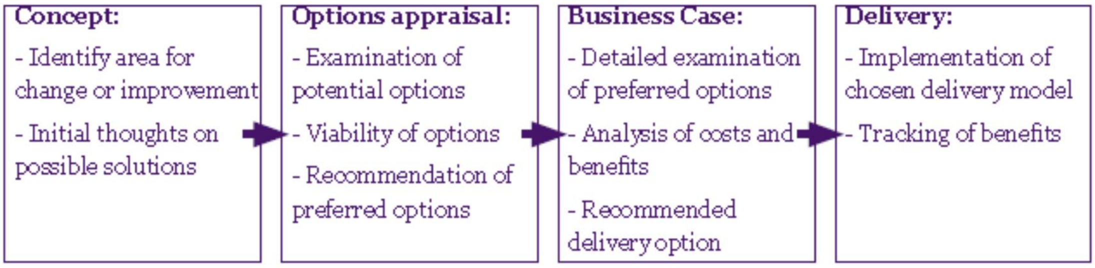
The approach it takes in respect of each of the services it provides to determining how best it should be produced as set out in the following schema:

---

[3] Commission Impossible? Shaping places through strategic commissioning available at: http://www.localis.org.uk/images/localis_commissioning_report_web_final.pdf

[4] available at: http://www.southglos.gov.uk/documents/Final-Commissioning-Procurement-Strategy-2014-18.pdf

[5] see Meeting the challenge in Barnet: Lessons from becoming the Commissioning Council available at: http://www.localis.org.uk/images/loc_barnet_commissioning_web.pdf



There is no particular preference for outsourcing, privatisation or any particular mode of production. Rather the focus for each service is what will deliver the best outcomes. Examples include:

- Recycling which had been outsourced was taken back in-house as analysis concluded the Council could do a better job than the private sector.

- The Council worked with its music teachers to create a social enterprise - a charitable trust funded by the Council (education is a significant function of local government in the UK and the Council had some 50 people involved across its district engaged in its music teaching service).

- It concluded it lacked the scale to support an in-house legal team with the breadth of experience and capability required. It contracted with a neighbouring local authority which now provides legal services for both councils.

- It formed a joint venture with Capita to undertake back-office services for the Council itself, and to contract with other councils to do the same (taking advantage of the opportunities presented by broadband).

What this brief overview is intended to illustrate is the changing emphasis on the role of local government becoming more one of strategic leadership for its communities rather than simply service provision. It suggests that increasingly the focus for councils will be less on the actual production of services (although this will remain important) and more on understanding what matters for their communities, and what this means in terms of who should be doing what.

In turn this suggests that approaching the decision on the waters CCO should include considering whether the future role of the Council should:

- Be concentrating on a somewhat narrow range of core services, or

- Shift more to one of strategic leadership able to focus not just on the current range of services, but on what will be needed for its communities to cope with a rapidly changing environment.

Determining what it s role should be will enable the Council both to consider what protections/options need to be in place as part of the establishment of the CCO to support the Council’s on-going role in relation to its communities, and to determine what the Council’s own future staffing and other resource requirements will to be.

The pros and cons of a CCO structure

The basic argument in favour of the use of a CCO structure is the relatively simple one of choosing the best tool for the purpose. For activities which combine the need for significant commercial skills, the need to take a long-term focus, and responsibility for technically sophisticated activities, it will often be argued that a CCO brings advantages which a council business unit or other form of activity does not including:

- An operating environment more consistent with the nature of the activity and more likely to attract people with the requisite skills.

- The ability to select people responsible for governance on a 'fit for purpose' basis, rather than through what some will see as the lottery of the electoral process.

- Relative freedom from political interference including some distancing from the impact of the three yearly electoral cycle.

- A more appropriate decision-making environment - the nature of council processes and the extent of public accountability are not always seen as consistent with making the right decisions within the right timeframe, especially when significant commercial matters are involved.

- A much clearer focus than may be the case with a council with its wider range of responsibilities (a point picked up in the consultant's assessment of options).

Beyond those relatively straightforward points however, assessment becomes somewhat more complex because of the need to take account of the real world environment in which CCOs operate.

This makes it critically important that councils, council management, CCO boards and CCO management each understand the environment in which the model operates and are well aware of both the formal and informal constraints they need to observe.

As one of the cons for the CCO model set out at page 30 of the report, the consultants state:

- Accountability to Councils is more remote.

From a Council perspective this is not necessarily ideal. In 2014 the Auckland Council began a review of the operation of its CCOs. The review included interviews with CCO board members and officers, and with elected members and senior staff of the Council. The report on the council interviews (completed before the recent controversy over the Ports of Auckland) includes the finding "There was strong feedback that when issues or problems arise in relation to a CCO's activities, the public and media hold elected members accountable and not CCO boards of directors."

This reflects a reality which any decision to form a CCO needs to take into account. It is elected members whom the community will hold accountable in the first instance.

One consequence is that tension between CCOs and councils is not uncommon. At the heart of it is both the nature of the accountability regime and how it is understood.

The consultants' report outlines the conventional approach to CCO accountability. Typically this runs on an annual cycle with a letter of expectations from shareholders to the board of the CCO spelling out what the shareholders expect in the coming year, preparation and discussion of a draft statement of intent, finalisation of the statement of intent and then periodic reporting back to shareholders by the board as required by the statement of intent which among other things facilitates monitoring by the shareholders of financial, operational and other performance. It also normally includes the development of a shareholder's expectations manual which spells out in more detail the kind of behaviours and performance expected both from the CCO and from the council.

In the real world what matters is not just formal compliance with a set of procedures/practices but also and crucially how the different participants understand the nature of their role and the environment in which they will be functioning. One problem is that it is usual to compare the state-owned enterprise operating environment with the CCO operating environment as though the responsibilities and accountabilities were broadly similar. The reality is they are not. The following table taken from an article written by Peter McKinlay for the Asia Pacific Journal of Public Administration compares the two.

Comparison of central government and local government positions on corporatising trading activities	
Legislation enabling the corporatisation of central government owned trading enterprises developed to meet central government objectives	Legislation enabling the corporatisation of local authority owned trading enterprises imposed by central government
A single owner, 'the Crown' was able to develop coherent and consistent policy to apply to each Crown owned trading enterprise	Multiple owners and no process in place for developing consistent policy to be applied across local government
Focus on maximising the value of the Crown's investment which often implied privatisation in the belief that private ownership would be better placed to extract full value	Focus on service delivery rather than maximising the value of the activity itself
Accountability concentrated on improving financial performance with some corporate social responsibility obligations	Accountability focused on meeting community objectives, and the expectation councils will be held democratically accountable.
A single consistent monitoring regime, centralised in the Treasury and based on best practice corporate governance	No consistent approach, a varying understanding of corporate governance, and highly variable performance.

What this table highlights is the varying understanding across local government of the role and purpose of CCOs, the nature of governance, and the quality of monitoring.

The same applies to understandings within the directorial community of the nature of the director role within a CCO. Most directors likely to be considered for appointment will have had their previous experience either in the private sector and/or on the board of a state-owned enterprise. Neither of those environments really provides directors with a good understanding of what it is to be on the board of a council owned entity with the formal and informal accountabilities to the community which come with that.

One of the issues here is the conventional directorial understanding that it is the role of the board to manage the business of the company and generally the shareholder has no power to intervene (there is case law supporting the prerogative of directors to refuse to follow a shareholder directive). This can in a

CCO environment translate into a sense that it is not appropriate for councils to raise operational matters with CCO boards (other than to the extent enabled by the SOI). As an example, in the recent Ports of Auckland wharf extension debacle, the position which the board took was that going ahead with a resource consent application, structured in a way to avoid public notification, was entirely consistent with its responsibility to run a successful business because this was required in order to manage increasing demand. As such, it appears not to have been seen as a matter to raise with the shareholder despite the presence of an admittedly rather limited no surprises policy in the SOI.

An alternative way of looking at the CCO model is to see it as an accountability model despite the consultants' view that accountability to councils is more remote. This does, however, require councils to be very focused on what kind of accountability they require and to ensure that this is delivered.

The ability to ensure that statements of intent include the kind of accountability requirements councils will want to have in place to ensure that their own accountability to their communities is properly supported is provided by the following subclause in the listing of the contents of an SOI. It is to include:

- any other matters that are agreed by the shareholders and the board.

Theoretically, a board could refuse to agree, but this should be relatively unlikely assuming that shareholders were clear at the time of the appointment of a board on what the expectations were, and that these were clearly spelt out in the letter of expectations preceding the drafting of the SOI.

This opens up the possibility for the SOI to cover matters such as:

- The nature of the briefings which shareholders might require from time to time over and above the formal quarterly or half yearly reporting provisions which the SOI will include.

- The shareholders' expectations regarding how the CCO will engage with the communities it serves.

- Provisions requiring the CCO to adopt a community charter (recommended by the consultants) and performance targets in respect of consumer related matters coupled with provision for compensation in particular instances - for example unwarranted interruption of supply (there is precedent for this approach with the regime which was adopted in England and Scotland following the privatisation of water).

- Matters which may be priorities for the shareholders in the way in which the board manages the CCO. One example could be a commitment to a 'least water in least water out' approach to the development of further infrastructure. Another could be measures to ensure that the CCO collaborates effectively with shareholder councils on matters where for operational reasons they need to work closely with the water services provider.

It does need to be emphasised that the effectiveness of the CCO model is very much dependent not just on the calibre and understanding of the board of the CCO, but also on the competency and understanding of those elected members or other council representatives with responsibility for dealing with the CCO including how they work with each other.

Here we pick up on a theme which comes through the consultants' report although not addressing specifically the question of council capability in dealing with a CCO. This is the perception that councils as such face both procedural and political difficulties in collaborating. This is seen in the consultants' comment on the ESS model:

> It should be noted that the decision making and approval process has proved difficult even for the existing limited shared services arrangement. In addition the lack of certainty as to whether councils will remain engaged for the long term will be detrimental to what is a long term infrastructure business. Shared services arrangements are best suited for low risk, low complexity activities rather than water services.

The same view is also expressed in respect of the non-asset owning CCO alternative in respect of which the consultants say "Its strengths and weakness would be very similar to ESS."

This directly raises the question of the extent to which councils can be expected to work together consistently over the long term in a way which optimises benefits for their collective communities. It is certainly the case that shared services endeavours in New Zealand have suffered significantly from councils finding it difficult to compromise different objectives or different views on how any particular activity should be managed. More generally, the relative failure of shared services to become common within local government has often been attributed, both within New Zealand and Australia and until recently in England, (the impact of financial austerity has driven a major attitudinal change) to the unwillingness of the management and elected members of different councils to give up some of their influence over individual services.

What this suggests is that particular care would be necessary both in designing the framework in which any monitoring arrangements are set, and in selecting the people who should be responsible for overseeing the monitoring of the CCO.

Conclusion on pros and cons of CCOs

We do not think that the material which has been presented to the three councils displays a systemic bias in favour of CCOs. Rather it seems to us that the focus has been on developing the 'ideal world' best option from a cost-effectiveness perspective. This is understandable. There are strong economies of scale arguments in favour of relatively large water utilities coupled with arguments that the company form of ownership has significant advantages in terms of timely and effective decision-making (a point made by the consultants).

Where we do believe that the reports could have gone further in highlighting issues which councils should consider in deciding whether or not to form a CCO is in these areas:

- The importance of ensuring that the people involved in the governance and management of the CCO, both from or on behalf of councils, and from the CCO have an in-depth understanding of the nuances of governing and managing a council owned company in what is an inherently sensitive area.

- The measures which the councils should have in place in order to protect their long-term interests, including the input which they will require from the CCO to support other council activities (for example economic development, environmental management, land use planning, working with iwi).

- The acceptability of moving immediately from the present council owned and controlled situation to one in which the water and wastewater businesses are wholly owned and operated by an arms' length entity especially given the difficulty of reversing this in the event that one or more councils, once they have experienced the CCO asset owning option, decide they wish to revert to council ownership and control.

There are two aspects to the point on acceptability. The first is the importance of building trust and relationships between the three councils and the CCO at operating, senior management and elected member level. This can be seen in the approach of Wellington Water Ltd which was established initially as a joint venture between the Wellington and Hutt City Councils to manage their three waters and now, as Wellington Water Ltd, is jointly owned by those two councils plus the Porirua and Upper Hutt City Councils and the Greater Wellington Regional Council and manages the water undertakings of all five councils. The current statement of intent for Wellington Water Ltd places a very heavy emphasis on relationship management and building trust between all the parties involved.

The effective working of the proposed asset management CCO will necessarily be very dependent on close collaboration between the three councils and a relatively seamless approach to decision-making. Given the reservations expressed by the consultants regarding the workings of the present shared services operation (which look to be as much as anything else about lack of harmonisation of internal processes within councils) there may be a case to be cautious about proceeding directly to an asset owning CCO rather than adopting the intermediate course of a water management CCO unless councils are confident that whatever the nature of the present difficulties, they can be put behind them.

The second point is the likely public response to the proposed formation of the asset owning CCO when the proposal is taken to public consultation. The first observation to make is that, before this happens, councils should be satisfied that the proposal on which they go to consultation answers any likely questions from the public regarding the future role of the CCO, and how the change will affect whatever interests different sectors within the community may have.

A second observation is that councils should have some sense of what the possible responses to public consultation might be. New Zealanders generally appear to be somewhat sensitive about the corporatisation or privatisation of what are seen as 'essential' services. The potential to organise substantial opposition very quickly is now very real given the power of social media (the ability of cycling enthusiasts to organise more than 10,000 social media submissions on the Auckland Harbour Bridge Sky Path proposal is a good recent example). What are the relative risks of substantial opposition to the formation of an asset ownership water CCO as opposed to some other option? Would councils facing substantial opposition through the public submission process feel obliged to be guided by that notwithstanding the strong views expressed in the reports the councils have received in support of the CCO option?

This leads on to the third matter which this paper addresses, ensuring that the Council retains discretion in areas of importance to it and its communities.

The role of a shareholders' agreement

The consultants' report identifies a number of matters which councils will want to have in place if a CCO is established, for example "It will be important to develop strong coordinating mechanisms between the CCO and council planning functions to ensure alignment between water network development and council growth plans. These can be mandated in the CCO constitution and SOI."

MDL would suggest a somewhat different approach. The just quoted extract provides an illustration. Given the nature of the growth which the three councils expect over coming years, the strong coordinating mechanisms will need to be not just between the CCO and an individual council or councils but amongst councils themselves.

The constitution of the CCO is not an appropriate document in which to spell out how shareholders should coordinate matters which are not inherently connected to their shareholding. Nor is the SOI an appropriate document for spelling out coordination amongst the parties. It is the directors' document responding to the shareholders' expectations for how the directors will manage the business and is written from the board's perspective.

We understand that the McGredy Winder review identified a number of matters which would need to be addressed from a shareholder's perspective and advised that Waipa's ability to secure the identified benefits for its water users depends on:

- The governance arrangements that are put in place, and

- The ability of Waipa to work with the other shareholders and the CCO board to make the CCO successful.

We concur with this view and also strongly recommend that, as one mechanism for achieving this, a shareholders' agreement be developed between the three councils. This would cover a number of matters including, for example:

- The nature of the monitoring arrangements which should be put in place, including who would have responsibility for managing those, and against what criteria people responsible for overseeing the monitoring process would be selected (we note that the consultants' report recommends an establishment committee made up of two councillors from each council. There may be merit in that committee including people selected on a 'fit for purpose' basis with the necessary skills and experience to oversee the monitoring of a major and technically complex business).

- As part of the monitoring arrangements, how the councils would go about jointly agreeing matters such as a shareholders' expectations manual, shareholders' letters of expectation, and agreement on the statement of intent with the board.

- Those matters which, as a minimum, councils would require to be included in a statement of intent. This could range from how the CCO was expected to engage with consumers, to the creation of a customer charter, to performance indicators and penalties for non-performance if those were seen as appropriate.

- The process and criteria for selecting directors for the CCO (we concur with the view that councillors and for that matter council staff should not be eligible for appointment because of the inherent conflict of interest involved).

- How to ensure transferring the three waters functions to the CCO did not compromise Waipa’s (and other councils’) interests in ensuring on-going alignment and coordination with the other matters for which the Council is responsible now or in the future. This could include the shareholders’ agreement giving Waipa (and other councils) the right to require certain inclusions in the statement of intent. These provisions would need to be carefully drafted to ensure that they were setting an operating framework within which the board will conduct the business, rather than seeking to interfere directly in the conduct of the business itself.

- How to deal with shareholding matters as such, ranging from ensuring equity between individual councils on financial matters in relation to the CCO to admitting additional councils as shareholders to responding to any requests for increases in capital, to the conditions under which an individual shareholder could withdraw, to winding up the company.

- Dispute resolution procedures.

Conclusion

MDL concludes:

- There is no inherent bias in favour of an asset owning CCO. Rather there appears to have been an ‘ideal world’ approach to determining the best option against the criteria set out in section 17 A of the Local Government Act.

- The process of taking the decision itself provides an opportunity for the Council to consider how it should approach its ongoing role on behalf of its communities -should it simply be one of downsizing in response to a lesser operational responsibility, or should it move to more of a strategic focus on providing leadership to its communities?

- In approaching any decision to participate in a waters CCO, the Council should consider the acceptability of moving straight to an asset owning CCO rather than, initially, a management CCO akin to Wellington Water Limited. This would address matters such as (1) ensuring through experience that the requisite level of trust and confidence and operational compatibility exists amongst councils themselves and between councils and the CCO at governance, senior management and operational levels and (2) the likely response through public consultation and the extent to which the Council would feel bound to be guided by public reaction especially if it were strongly negative.

- On the assumption that the Council does decide to undertake consultation with its community on the formation of a CCO (whether an asset owning or management CCO), the Council and indeed all the councils should be satisfied that the proposal on which they go to consultation answers any likely questions from the public regarding the future role of the CCO, and how the change will affect whatever interests different sectors within the community may have.

- The establishment of a CCO will require very careful attention to a number of matters including governance, the relationship amongst the different parties, the ability of and requirements on the CCO to operate in a manner supportive of the continuing democratic accountability of councils for water services, how the CCO works with its customers, collaboration with councils to ensure that their ability to plan and deliver in other areas of activity is not adversely affected (ideally is enhanced) and how council understanding of the customer experience is ensured so that councils can continue to make informed decisions on behalf of customers (for example in agreeing relevant parts of the statement of intent).

- The relationship amongst the three councils should be set out in a shareholders' agreement which will need to be sufficiently comprehensive to cover all of the matters which the Council wants to ensure are protected once the CCO is in place. This could suggest the Council running a number of scenarios on matters which it thinks could arise in order to determine what provisions should be included in the shareholders' agreement.