

PwC Report

1. Summary

Introduction

1.1 We have been jointly engaged by GWRC and PCC to undertake a high-level assessment of the merits, risks, advantages and disadvantages if either or both councils were to outsource management of their infrastructure assets in some form to Capacity Infrastructure Services Limited or a Capacity-like entity.

1.2 HCC, UHCC and WCC have effectively amalgamated elements of the delivery of water¹ services by contracting Capacity to manage operational and some management aspects of their networks. The purpose of our analysis has not been to evaluate the performance of Capacity. Rather, it has been to consider the issues associated with amalgamation and how it might be structured. Whether Capacity is the vehicle to facilitate amalgamation is a secondary issue, although it is important to acknowledge that Capacity has infrastructure and skills in place.

The Rationale for Change

1.3 The case for amalgamation for either GWRC or PCC is not necessarily straightforward. There is no immediate imperative for either Council to change the way they deliver water services, although PCC has expressed some concerns about its ability to attract and retain staff in the long term.

1.4 In these circumstances the principles that guide the Council's decision making are particularly important. The primary principle is that any change in delivery of water services must produce demonstrable reductions in cost for given levels of service. Alternatively, the change must produce an increase in quality of service for a given level of cost.

1.5 A key issue complicating consideration of the amalgamation options is determining what level of amalgamation should occur. Through Capacity, the HCC, UHCC and WCC have amalgamated operational and some management elements of their water activities. This is one level of amalgamation but amalgamation could extend beyond this to encompass other aspects of management of the networks and asset ownership matters such as policy development and strategic planning.

1.6 Capacity has produced benefits for its customers, both financial and non-financial. The financial benefits have been in the form of savings in:

- Capacity's own costs relative to the comparable costs that would have been incurred by the councils if Capacity had not been established. These savings are important but have been relatively minor in the scheme of total operational costs.
- Network operating costs (the costs of maintaining and operating the networks – this work is largely undertaken by contractors under contracts managed by Capacity). Savings have been achieved for the HCC. The cost savings to the WCC have been impacted by scope changes and some one-off costs.
- Capital expenditure through deferring or changing capital expenditure requirements. Capacity claims to have achieved very significant current and future capital expenditure savings.

¹ In this report water assets or water services refers to potable water, wastewater and stormwater collectively.
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1.7 Capacity has suggested that it could achieve more for its customers if its scope of activities were expanded. This is consistent with our view that the benefits from amalgamation will be maximised if the scope of amalgamation supports a long term, whole of network perspective and allows the amalgamated entity to plan and make decisions that optimise the mix of operating and capital expenditure and resource allocation across entire network(s). This suggests a wider and deeper rather than a narrower and shallower scope of operations.

1.8 This is not to say that there will not be short term benefits from amalgamation. Capacity has shown these can be achieved. However, the issue for the GWRC and PCC is that moving water operations into an amalgamated entity will require both councils to restructure and/or absorb overheads that are currently being supported by the water operations.

1.9 We suggest that the direct savings in placing GWRC and/or PCC personnel into an amalgamated entity are unlikely to be compelling (not least because of the overhead restructuring each council will have to undertake). A compelling case for change needs to be built on savings in operating, maintaining and developing the networks or providing enhanced service given current costs. These benefits are likely to accrue over the longer term.

1.10 The sheer scale of the water activities across the region, the commonality among the various networks and the integrated nature of the potable water network strongly suggest that integration of the management and operation of the water activities should yield benefits. The benefits will result from economies of scale, adopting best practice across the networks and enhanced coordination and cohesion through vertical integration² as well as horizontal integration³.

1.11 While there might be merits in amalgamation, there will also be issues to address and risks to mitigate:

- An amalgamated water entity will be of significant size. The contractual arrangements between the councils and the amalgamated entity would need to reflect an appropriate balance of rights and obligations. The councils would need to avoid being captured by a monopoly supplier.
- In our view, amalgamation should be on the basis of achieving long term benefits from broad and deep amalgamation. How broad and how deep will depend on the level of control and influence over the water services and assets the councils consider they need to retain.
- Quantifying amalgamation benefits needs to take into account the costs to the GWRC and PCC of dealing with overhead costs that are currently allocated to and supported by the water activities. These costs are not inconsequential.
- It is conceivable that the benefits of amalgamation may not necessarily be proportional to each council's contribution to the amalgamated entity. The councils would need to consider the weight they put on benefits of amalgamation to the region compared to the benefits to their local communities.
- Maximising amalgamation benefits, particularly in relation to potable water, will require the four TAs and the GWRC to agree on the scale and scope of the amalgamated entity. This could be challenging if previous attempts at region-wide amalgamation are any guide.

² Managing the potable water network as a single integrated network from water source to delivery to end customers.

³ Managing the wastewater and stormwater networks together.

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Summary Conclusions

1.12 In summary, we are of the view that:

- There will be benefits in integrating the management and operation of the water networks and activities.
- Integration will be best achieved through amalgamation (as opposed to some form of contractual arrangements between the councils)
- The extent of the benefits will be a function of the extent of amalgamation. The benefits from amalgamating potable water activities in particular will be enhanced if the amalgamated entity is empowered to make strategic as well as operational decisions for the networks as a whole.
- The amalgamated entity should have a business-like focus (which doesn't necessarily mean profit maximising).
- A company is an appropriate legal form for the amalgamated entity – it is entirely consistent with a business-like focus.
- The need for amalgamation to include transferring ownership of the water networks from the councils to another party is not certain. The critical issue for the amalgamated entity is being able to make decisions about efficient deployment and utilisation of assets over and between networks, irrespective of council boundaries. This requires control of the networks in the first instance.

1.13 Should the Councils decide to further investigate amalgamation, there will be a number of issues that they will need to address. This will include the need to definitively prove the case for change, confirm the scope of operations to be amalgamated, confirm the institutional arrangements, and map out an implementation process that balances timetable issues with the need for the Councils to manage their risks during implementation.

1.14 An implementation process that involves appropriately defined stages and a realistic timetable will be important to managing risk to the councils. Should either or both GWRC and PCC decide in the future to proceed with amalgamation, it should be on the basis of having an implementation process that minimises the risks of any adverse deterioration in quality of services during the transition phase (and beyond). This would most likely require processes to deal with issues such as differences in operating standards and service levels to ensure service levels are at least maintained during the transition.