



REPORT OF  
THE CONTROLLER AND  
AUDITOR-GENERAL  
ON  
PAPAKURA DISTRICT COUNCIL:  
WATER AND WASTEWATER  
FRANCHISE



Report of  
The Controller and  
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on  
Papakura District Council:  
Water and Wastewater Franchise

April 1998

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Hon Doug Kidd  
Speaker  
House of Representatives  
WELLINGTON

Mr Speaker

I am pleased to forward this report to you for presentation to the House of Representatives pursuant to section 33 of the Public Finance Act 1977.

The franchise agreement entered into by the Papakura District Council for the maintenance and operation of its water and wastewater services was the first of its type in New Zealand by a local authority for an essential service. We are aware that other authorities are investigating this option for the delivery of their water and wastewater and other services. Accordingly, we considered that it was timely to investigate the situation in Papakura and to highlight issues and lessons to be learned.

The use of a franchise agreement of this type can be a viable option for the delivery of local authority services. However, there are inherent risks which must be minimised through the actions of local authorities in the development, implementation, management and monitoring of such an agreement.

Our audit has identified a number of these risks and we hope that other authorities will benefit from a greater awareness of the processes which need to be followed in order to make such an arrangement work.

D J D Macdonald  
Controller and Auditor-General

Wellington  
30 April 1998



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## SUMMARY AND RECOMMENDATIONS

### Summary

#### *Impetus for Change*

Changes to local government legislation, public expectations and other public sector reforms have seen the introduction of an increasing number of private and public sector partnerships throughout New Zealand. The positive results and benefits for ratepayers have encouraged local authorities to develop new alternatives for traditional means of service delivery.

The Papakura District Council (referred to as “the Council” throughout the rest of this report) has been an enthusiastic supporter of the reforms, and is the first local authority to put a water and wastewater total facilities operation and maintenance contract in place with a private company. We recognise that the Council has taken an innovative approach towards the delivery of services to its community.

#### *The Costs Involved*

The control and supply of water and wastewater are important issues that arouse strong emotional feelings in many people. Communities believe that – over time – they have invested significant resources in development of the existing system, and they are reluctant to see it sold. In addition, people feel that water is an essential commodity and that “paying” for it is not acceptable.

The reality is that there are significant costs associated with the supply of water and disposal of wastewater. Many local authorities are faced with the prospect of having to invest significant capital to upgrade their existing networks. The challenge that they face is to provide the best system to meet the public’s expectations in a financially prudent manner.

#### *The Franchise Agreement*

The Council’s franchise agreement (referred to as “the Papakura agreement” throughout the rest of this report) is essentially a facilities maintenance and operations contract under which the franchisee is responsible for all aspects of the water and wastewater services for consumers within the Papakura District.

The Papakura agreement:

- ↓# Resulted in payment to the Council of a \$13 million franchise fee.
  
- ↓# Fixes the retail price of water until July 1999, after which charges are restricted to being at or below the Auckland Average prices for water and

wastewater services. This means that the price to the consumer could move from the lowest in the region<sup>1</sup> to the Auckland Average Price<sup>2</sup>.

- ↓# Provides for wastewater charges to be based on 80% of metered water consumption, rather than based on land value.
- ↓# Retains the water and wastewater assets in public ownership.
- ↓# Passes responsibility for maintenance and development of the water and wastewater systems to the franchisee.

### *Information Is Essential*

Our audit has highlighted the need for accurate information and planning for the life of the assets in the form of an Asset Management Plan. The long-term success of a franchise agreement will rely upon the local authority having confidence that required service standards are being maintained and that the water and wastewater networks are protected. Without sufficient baseline information, the management, monitoring and renewal of a franchise agreement carries significant risk.

The Papakura agreement stipulates that the franchisee, United Water International Pty Limited, will produce an Asset Management Plan before July 1998. The Council will need to ensure that this plan is suitable for monitoring and management of the agreement and protection of the assets. We will be reviewing this aspect of the agreement in a future audit.

### *Our Conclusions*

The adoption of an agreement of this type by a local authority is a pioneering step in New Zealand, and it would be unreasonable to expect the agreement to be perfect. How well the Papakura agreement will work in practice will not be known for some time. Although the terms of the agreement met the majority of our expectations, we have identified some matters of concern and issues for our follow-up audit.

### *Acknowledgment*

We would like to thank the Council for its assistance in our carrying out of the audit. We trust that this report will be of benefit both to the Council and to other local authorities that are currently investigating similar options. By assisting with our audit of the Papakura agreement, the Council has provided a valuable insight into the practicalities of setting up such an arrangement.

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<sup>1</sup> The terms “region” and “regional” in this report refer to the combined areas of Auckland City, North Shore City, Manukau City, Waitakere City, Rodney District, and Papakura District.

<sup>2</sup> For the purposes of calculating the “Auckland Average Price” the agreement excludes from the region Rodney District and Papakura District.

Readers' attention is drawn to our earlier publication *Contracting for Maintenance Services in Local Government*.<sup>3</sup>

## **Recommendations**

We make the following recommendations under the topic headings shown.

### *Steps Before Tendering (Chapter 2)*

We recommend that, when a local authority is preparing to tender its services, it should:

- ↓# Develop and document clearly what it wants to achieve for the delivery of each of the services before considering how they will be delivered.
- ↓# Carry out sufficient consultation to assure itself that it has identified the needs, issues and any concerns the community might have. This process should be clearly recorded and documented and used in the decision-making process.
- ↓# Develop and publish objectives for the management and operation of the services concerned. The objectives should be designed to include protection of the long-term interests of ratepayers.
- ↓# Invest sufficient time in conducting the tender process to ensure the quality of the ensuing agreement and to protect the long-term interests of ratepayers and users of the service.
- ↓# Complete an Asset Management Plan for the assets involved, or put in place a process to ensure that an Asset Management Plan is produced before tendering for a management and operational agreement. The Asset Management Plan should have regard to the guidelines set out in the *New Zealand Infrastructure Asset Management Manual*.
- ↓# Demonstrate, for each service, that (so as to meet the requirements of sections 247D and 122C(c) and any other appropriate sections of the Local Government Act) it has considered the advantages and disadvantages of the proposed approach compared to the alternatives and how the preferred approach represents value for money.
- ↓# Consider and document the full range of options for different franchise durations, and the benefits which each alternative will provide.

### *Conducting the Tender (Chapter 3)*

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<sup>3</sup> The Audit Office, June 1997: ISBN 0 477 02849 7.

We recommend that, when a local authority is conducting a tender for franchising a service, it should:

- ↓# Prepare a marketing plan setting out how it intends to maximise exposure of the tender to potential tenderers.
- ↓# Adopt a range of selection criteria (including both price and non-price attributes) which are designed to ensure that any preferred tenderer will:
  - ≠ meet the strategic objectives for service delivery;
  - ≠ be committed to providing a quality service; and
  - ≠ employ innovative and alternative ways to provide the service.

#### *Drawing Up the Franchise Agreement (Chapter 4)*

We recommend that, when a local authority is drawing up a franchise agreement, it should:

- ↓# Ensure that an agreement is designed to meet the objectives for delivery of service.
- ↓# Have regard to the expectations set out in the Appendix on pages 65-69. In particular, it should give consideration to issues of:
  - ≠ identifying the long-term interests of the ratepayer and structuring the agreement to protect them;
  - ≠ price control; and
  - ≠ the authority's role and responsibilities to monitor customer satisfaction, service quality, asset maintenance, and non-performance by the franchisee.
- ↓# Set clear standards to ensure that the franchisee knows what it is expected to do and to provide an objective basis for managing the agreement to the level of assurance required.
- ↓# Ensure that the agreement requires the franchisee to set up a customer charter which covers a specified range of issues. The charter should have regard to the customer agreement guidelines issued by the Association of Local Government Engineers of New Zealand (ALGENZ).

#### *Managing and Monitoring the Franchise (Chapter 5)*

We recommend that, when a local authority is determining how to manage and monitor a franchise, it should:

- ↓# Establish the necessary systems and allocate suitable resources to manage and monitor the franchise from its commencement.
  
- ↓# Implement a programme of auditing the performance of the franchisee to provide the level of assurance it requires. The programme should incorporate risk-based audits, systematic inspections of work quality, and periodic reviews of the franchisee's quality control systems. Where possible, the auditing function should be integrated with the monitoring of asset condition, and the results of audits documented to provide a record of contractor performance and a source of data for future retendering.
  
- ↓# Develop an Asset Management Plan which establishes clear benchmarks of existing asset condition and service levels. This will provide a sound basis to develop clear procedures for:
  - ≠# dealing with poor performance or non-performance by the franchisee;
  
  - ≠# assessing the required condition of the assets to before they are returned to the authority's control at the end of the franchise;
  
  - ≠# dealing with a range of extreme events; and
  
  - ≠# communicating with the franchisee as a basis for ongoing administration of the franchise.

## INTRODUCTION

101 Since it was formed in 1989, the Council has introduced the use of private sector delivery of a wide range of services. It adopted a philosophy of:

*If private sector enterprise can do the job quicker, better and cheaper, then they got the work.*

102 In December 1996, the Council announced its intention to investigate a proposal for delivery of its water and wastewater services in the form of a franchise. In the same month, the Council carried out a period of public consultation, and heard submissions from the public in January 1997. In February 1997, based upon the interest which had been expressed by contractors, the Council approved a draft franchise agreement and put the franchise out to tender.

103 The tender process was completed by July 1997. The Council signed a franchise agreement with United Water International Pty Limited (referred to as “United Water” or “the company” throughout the rest of this report) to operate the water and wastewater services for up to 50 years<sup>4</sup>.

104 The Papakura agreement is essentially a facilities maintenance and operations contract under which United Water is responsible for all aspects of delivering water and wastewater services (including administration and billing) within the Papakura district. An important aspect of the franchise approach is that the water and wastewater networks (“the assets”) remain in public ownership. The Council adopted the term “franchise” because of the once-only franchise fee payable to it under the agreement.

105 The franchise agreement is the core legal document evidencing the terms and conditions of the franchise that the Council and United Water are bound by and can enforce. Supplementary documents – over which the Council has no direct influence but which affect the conditions of service delivery to the users – are the customer charter and customer contract. The relationships are illustrated in Figure 1 on page 13.

106 The Council is the first local authority in New Zealand to adopt an approach of this kind. There is considerable interest, therefore, in the Council’s experience and the lessons which other authorities can learn when considering alternatives for delivery of similar services.

107 Our audit aimed to:

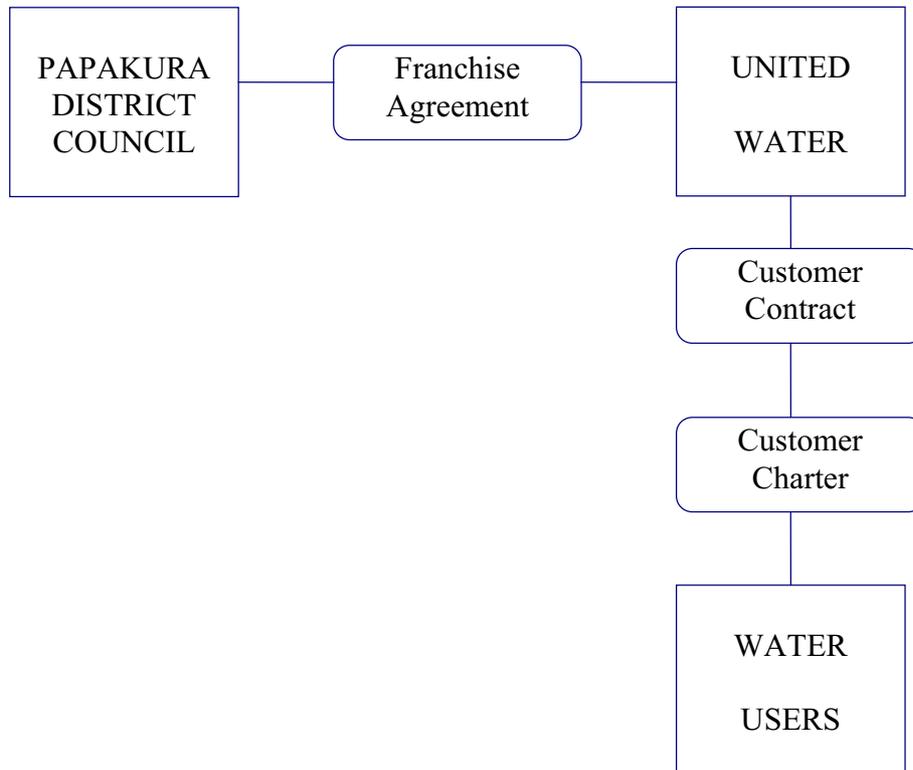
↓# evaluate the extent to which the Council has protected the long-term interests of ratepayers and water consumers in the franchise arrangement with United Water;

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<sup>4</sup> The initial term is 30 years, with provision for renewal for a further 20 years.

- ↓# establish the focus of a follow-up audit to evaluate the progress of the contract; and
- ↓# identify the lessons to be learned for other local authorities.

**Figure 1  
The New Relationships**



### **Background on United Water**

- 108 United Water is a joint venture of two major international water companies and an Australian-based engineering services company.
- 109 Compagnie Generale des Eaux (CGE) from France and Thames Water from the United Kingdom are among the world's largest water companies, supplying water to tens of millions of people throughout the world. With 150 years of experience, CGE is one of the world's oldest water service companies, and was the first water service company to achieve ISO9002 quality assurance accreditation for water treatment and distribution. Thames Water is involved with CGE in a number of Asia-Pacific joint ventures. The Australian engineering services company is Kinhill Engineers, which has particular expertise in environmental engineering and environmental studies.

## **Background on the Papakura District Council**

- 110 Papakura District is situated at the southernmost part of the Auckland metropolitan area, adjacent to Franklin District and Manukau City. Papakura has an area of 126km<sup>2</sup> and a population of 38,200.
- 111 The district contains a sewage collection and disposal network that comprises over 175km of pipelines, 20 pumping stations and a sewage treatment and disposal plant at Drury which deals with some of the wastewater for the district. Most of the wastewater is disposed of by Watercare Services Limited (referred to as “Watercare” throughout the rest of this report).
- 112 The district contains 160km of water mains together with numerous rider mains and leads, one pumping station and one header tank/reservoir. Watercare supplies approximately 5.1 million cubic metres of water a year to the district. About 75% of this water is delivered to 12,300 metered properties. The other 25% is consumed by unmetered purposes (such as firefighting, mains cleaning and mains repairs) and losses unaccounted for.
- 113 Of the Council’s total operating costs in 1996/97 of \$15.4 million, water supply accounted for \$2.9 million (18.8%)and sewerage accounted for \$3.0 million (19.5%).

## **How We Carried Out the Audit**

- 114 Using extensive research and expert advice, we developed a series of expectations designed to provide assurance that the long-term interests of the ratepayers and water consumers would be protected.
- 115 We then examined the way in which the Council had gone about setting up the franchise agreement and evaluated this against our “model” expectations.

## **Follow-up Audit**

- 116 We plan to conduct a follow-up audit in three years’ time in order to:
- ↓# assess the extent of monitoring by the Council;
  - ↓# determine the extent to which the original objectives have been met; and
  - ↓# review the appropriateness of the franchise approach.

## **Structure of this Report**

- 117 Chapters 2-5 of this report each contain:
- ↓# a chapter summary, including expectations and findings;

↓# recommendations; and

↓# detailed findings, conclusions and commentary for each specific expectation.

## STEPS BEFORE TENDERING

### Chapter Summary

#### *Expectations*

- 201 We expected that the Council would have:
- ↓# Developed a strategic approach to the delivery of services before considering individual options for particular services.
  - ↓# Consulted with the public and considered their feedback during the decision-making process.
  - ↓# Developed and published objectives for management and operation of the water and wastewater systems – and that the objectives would protect the long-term interests of ratepayers and water users.
  - ↓# Managed the tender process so as to allow sufficient time to maximise the benefits for ratepayers and water users.
  - ↓# Completed an Asset Management Plan for the water and wastewater networks, or put in place processes to ensure that an Asset Management Plan would be produced.
  - ↓# Considered the advantages and disadvantages of different franchise durations to maximise the long-term benefits to ratepayers and the community.

#### *Findings*

- 202 Since 1989, the Council has had a consistent approach of using the private sector where it can provide a service *quicker, better and cheaper*. During this period, the Council has debated the advantages and disadvantages of contracting against “in-house” or other alternative methods for the delivery of a range of services.
- 203 The Council did not formally document its debate on the advantages or disadvantages of the franchise approach to water and wastewater services against other options prior to the December 1996 Council meeting at which the approach was proposed.
- 204 In our view, the consultation carried out by the Council met the special consultative procedure requirements prescribed by 716A of the Local Government Act 1974 (referred to as “the Act” throughout the rest of this report).
- 205 The Council decided not to prepare an Asset Management Plan before letting the franchise, but required United Water to prepare a plan by June 1998.

### **Recommendations**

206 We recommend that, when a local authority is preparing to tender its services, it should:

- ↓# Develop and document clearly what it wants to achieve for the delivery of each of the services before considering how they will be delivered.
- ↓# Carry out sufficient consultation to assure itself that it has identified the needs, issues and any concerns the community might have. This process should be clearly recorded and documented, and used in the decision-making process.
- ↓# Develop and publish objectives for the management and operation of the services concerned. The objectives should be designed to include protection of the long-term interests of ratepayers.
- ↓# Invest sufficient time in conducting the tender process to ensure the quality of the ensuing agreement, and to protect the long-term interests of ratepayers and users of the service.
- ↓# Complete an Asset Management Plan for the assets involved, or put in place a process to ensure that an Asset Management Plan is produced before tendering for a management and operational agreement. The Asset Management Plan should have regard to the guidelines set out in the *New Zealand Infrastructure Asset Management Manual 1996*<sup>5</sup>.
- ↓# Demonstrate, for each service, that (so as to meet the requirements of sections 247D and 122C(c) and any other appropriate sections of the Local Government Act) it has considered the advantages and disadvantages of the proposed approach compared to the alternatives, and how the preferred approach represents value for money.
- ↓# Consider and document the full range of options for different franchise durations, and the benefits that each alternative will provide.

## **Strategic Approach**

### *Expectation*

207 *We expected that the Council would have developed a strategic approach to the delivery of services before considering individual options for particular services.*

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<sup>5</sup> Published by the National Asset Management Steering Group, ISBN 0-473-04149-9.

208 Section 247D of the Act enables local authorities to carry out their works and perform their functions in different ways and requires authorities to consider options for doing so. Authorities should be clear about the objectives for their services before assessing the alternative methods by which those objectives might be achieved. Authorities should also be able to demonstrate that the contracting practices which they choose are likely to produce results that represent value for money.

### *Findings*

209 The Council has had a consistent management approach towards the contracting out of services since 1989-90.

210 The services which the Council has contracted out include:

↓# Road and footpath construction and maintenance.

↓# Parks, reserves and public areas development and maintenance.

↓# Rubbish collection and disposal.

↓# Maintenance and development of the water, sewerage, and stormwater networks.

↓# Maintenance and construction of council buildings.

↓# Animal control.

↓# Resource management and building consents.

211 During this period, the Council has debated the advantages and disadvantages of a variety of approaches to the delivery of these services, including (in 1993) a joint venture with Watercare to provide water and wastewater services.

212 On 9 December 1996, the Council announced its intention to investigate a franchising approach for the supply of water and wastewater services by calling for expressions of interest.

213 The Council did not document its discussions of the specific advantages and disadvantages of the franchise proposals over the alternatives. Council officers said that these were self-evident to the Council given its experience of contracting out services since 1989.

214 The Council's 1996 Strategic Plan was available for public input in March 1996. In Section C – Strategic Issues and Directions, the plan included strategies to:

↓# *Promote options for the ownership and regulation of the bulk water and supply system which could provide competition and better service/customer relationship.*

↓# *Promote options for the ownership and regulation of the bulk sewerage system including treatment plants which could provide competition and better service/customer relationship.*

215 Council officers told us that the franchise option was not included in the 1996 Strategic Plan or the 1996-97 Annual Plan because it was not under consideration when those plans were written.

### *Commentary*

216 From 1 July 1998, section 122C(c) of the Act will apply to the financial management of all local authorities. This section outlines a principle of financial management that requires the benefits and costs of different options to be assessed:

↓# in determining any long-term financial strategy, funding policy, investment policy or borrowing management policy; and

↓# in making any decision with significant financial consequences (including a decision to take no action).

Complying with section 122C(c) would require an assessment of each activity that an authority is considering at the time when it is being proposed.

## **Public Consultation**

### *Expectation*

217 *We expected that the Council would have consulted with the public and considered their feedback during the decision-making process.*

218 Proposals to change the way in which essential services – such as water and wastewater – are delivered entail redefining the relationship between the service deliverer and the customer. A local authority should carry out sufficient consultation to:

↓# assure itself that the views of the local community have been considered in the decision-making process; and

↓# satisfy itself that it has met the requirements of the Act.

### *Findings*

219 Although there is no clear legal requirement to consult over a franchise or contract agreement, the Council resolved that this case was of such significance that public feedback was important and necessary. In order to achieve this feedback, it adopted the special consultative procedure prescribed by section 716A of the Act.

220 Briefly, the consultation involved:

- ↓# placing public notices in local and national newspapers;
- ↓# a six-week submissions period;
- ↓# wide coverage, both national and local, in all news media; and
- ↓# presentation of submissions back to the Council.

- 221 The Council received eight submissions during the six weeks allowed – four in support of the proposal and four others suggesting that the Council should go further and sell the assets.
- 222 After the deadline for submissions had closed, the Council received 25 further submissions complaining that the submission period was too short and included the Christmas and New Year holiday period. Most of these submissions came from people who lived outside the Papakura District.
- 223 Council officers told us that retaining the water and wastewater networks in public ownership was a key factor in providing assurance to Councillors that ratepayers’ long-term interests were protected.

### *Conclusion*

- 224 In our view, the consultation which the Council carried out met the special consultative procedure requirements prescribed by the Act.

### *Commentary*

- 225 Water and wastewater services are significant activities of local authorities, and any proposal for an alternative form of delivery is likely to be of strong interest to the public. In our view notwithstanding the lack of a statutory requirement public consultation is essential and would represent good management practice.
- 226 A local authority should carry out sufficient consultation to assure itself that it has identified the needs, issues and any concerns the community might have. This process should be clearly recorded and documented and used in the decision-making process. This will strengthen the authority’s case that it has considered the advantages and disadvantages of its proposal and the alternatives available.

## **Objectives**

### *Expectation*

- 227 ***We expected that the Council would have developed and published objectives for management and operation of the water and wastewater systems – and that the objectives would protect the long-term interests of ratepayers and water users.***

- 228 Section 247D of the Act enables local authorities to carry out their works and perform their functions in different ways, and requires authorities to consider options for doing so.
- 229 Section 247E requires every local authority to consider putting out to tender any contract that is likely to involve an authority in significant expenditure or financial commitment.
- 230 Local authorities should be able to demonstrate that they have developed clear objectives for the service and performance standards for service delivery. They should also be able to demonstrate how their chosen approach is likely to meet those objectives and standards and produce results that represent value for money.

### *Findings*

- 231 The franchise approach was decided by the Change Management Group of the Council. This was an informal group – comprising the four committee chairpersons, the Mayor, the Chief Executive and Council officers – which met to develop further options for restructuring and improvements to service delivery. The group first met in November 1996.
- 232 Council officers told us that the options of service delivery by LATEs and/or Council Business Units were debated and rejected by the Change Management Group. The Council believed that the advantages of the franchising approach were evident from the results of contracting out its water and wastewater maintenance services. These services were assessed in the LEK independent report to be 35% more efficient than those of other local authorities in the Auckland region.
- 233 No minutes of the Change Management Group’s discussions were taken; nor were the advantages or disadvantages of the franchise approach presented to, or debated or recorded by, any committee of the Council before 9 December 1996.
- 234 The Mayor presented the Council with a report on the franchise option and the reasons for pursuing that option at the Council meeting of 9 December 1996. The Mayor recommended that the Council immediately commence the section 716A special consultative procedure to consider the franchise proposal, and immediately call for expressions of interest. The Council adopted the Mayor’s recommendation.
- 235 The Council’s objectives for investigating the franchise option, as stated in the Mayor’s report and in subsequent press releases, can be summarised as follows:
- ↓# **Protect the interests of its ratepayers by locking in the current low-cost regime.** The Mayor’s report stated that the Council needed to act urgently, as Watercare had detailed a 310% increase in wastewater charges over the next 10 years. He said that the Council must *ACT NOW to protect the interests of ratepayers by locking in the current low cost regime.*

- ↓# **Retain the assets in public ownership.** The Mayor's report outlined his belief that *it is important to act now to protect the interest of our ratepayers and retain the remaining water and sewerage assets in public ownership.*
- ↓# **Gain the technical resources and experience of a large specialised company to run the system.** A small local authority could never attract or afford the type of experts that a large company would have.
- ↓# **Control price through the franchise agreement.** The Mayor's report also outlined his belief that *keeping charges to a minimum* was a key objective.
- ↓# **Move to a user-pays basis for water usage.**
- ↓# **Be the first such franchise in New Zealand and reap a financial premium for the Council.**
- ↓# **Provide a better service.**
- ↓# **Produce further restructuring and savings in the Council's operational costs.**

### Conclusions

- 236 The franchise agreement signed with United Water provides mechanisms or controls that are designed to meet the majority of the agreed objectives.
- 237 However, we note that when the franchise agreement was first proposed in December 1996 the Council accepted that the matter was urgent because of possible significant increases in Watercare costs (310%) over the next 10 years.
- 238 We are concerned that the manner in which the proposal was presented may have led people to believe that the franchise approach would provide some protection from Watercare price rises. The agreement allows all bulk supply price increases to be passed directly on to consumers according to current legislation.<sup>6</sup>
- 239 The Council's objective – to *protect the interests of its ratepayers by locking in the current low-cost regime* – is achieved by the two-year price freeze in the agreement. However, it is uncertain whether the objective will continue to be achieved after July 1999 when United Water can increase charges up to the Auckland Average Price. As part of our follow-up audit we will reassess our concern that such a price movement could fail 4 in the longer term 4 to meet the objective.

### Commentary

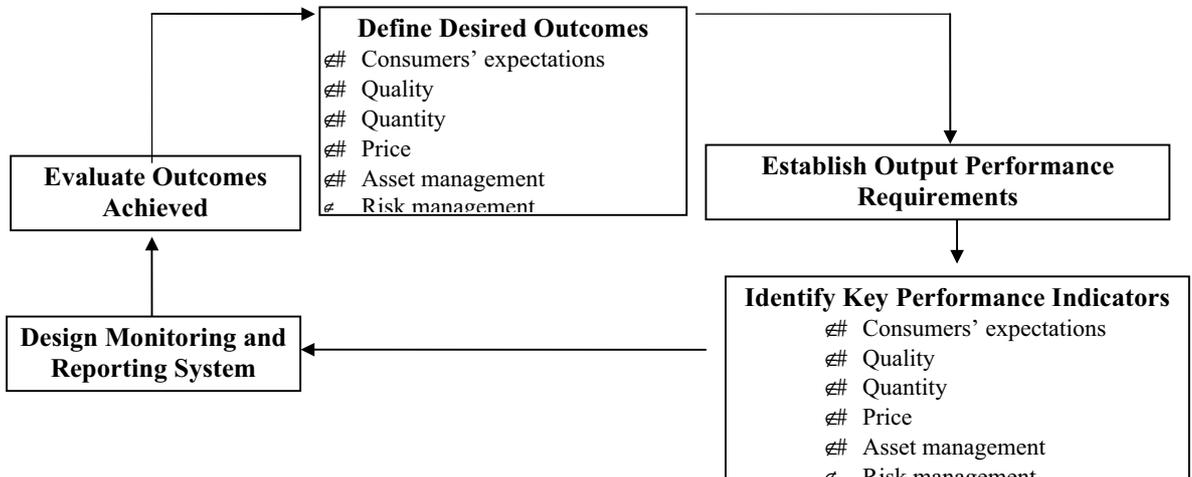
- 240 Section 247D of the Act requires local authorities to set out and record their objectives and the specific advantages and disadvantages of a proposal such as franchising water

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<sup>6</sup> Section 707ZF of the Local Government Act 1974 lays down extensive provisions governing financial and other aspects of the operations of Watercare Services Limited.

and wastewater services. Authorities need to be clear about what they are trying to achieve, what the community's expectations are, and how each method will produce the required result. See Figure 2 on the next page.

**Figure 2  
Setting and Monitoring Objectives**



## Time for Preparing to Tender

### Expectation

- 241 *We expected that the Council would have managed the tender process so as to allow sufficient time to maximise the benefits for ratepayers and water users.*
- 242 Decisions on the timing of a tender affect the risk to a local authority as the purchaser. Sufficient time should be invested in conducting the tender process to ensure the quality of the franchise agreement and to protect the long-term interests of ratepayers and users of the service. A quick process may result in certain benefits being obtained, but may unduly restrict the consideration of options.

### Findings

- 243 Council officers told us that, in their opinion, being the first local authority in New Zealand to adopt the franchise delivery option attracted a premium in excess of \$3 million within the total franchise fee obtained (\$13 million).
- 244 Council officers also told us that the decision on 9 December 1996 to call for expressions of interest for a franchise proposal was prompted by:
- ↓# The decision by Watercare to proceed with an upgrade of its Mangere sewage treatment plant. The Council believed that, based on the expert advice it had received, the estimated \$360 million cost was approximately twice the necessary cost for this plant.

- ↓# The result of the Change Management Group’s debate of further restructuring of the Council and alternative ways of service delivery by the Council.
- 245 Council officers further told us that the adopted timetable for setting up the franchise was influenced by the desire to:
- ↓# minimise disruption to Council staff;
  - ↓# start the franchise at the beginning of the following financial year (1997/98);
  - ↓# attract only franchisees capable of demonstrating commitment to the franchise and able to respond in a short time; and
  - ↓# be the first, and thus gain the financial benefits of market interest.
- 246 Franchising was raised as an option on 9 December 1996, and the franchise agreement was signed on 23 April 1997. The events leading to the start of the franchise are set out in Figure 3 below.

**Figure 3**  
**Sequence of Events**

9 December 1996	The Council announced that it would investigate the possibility of franchising its water and wastewater services.
14 December 1996	Public Notices inviting submissions from the public appeared in the press.
18 December 1996	Notices calling for registration of interest from water companies were published.
10 January 1997	Registrations of interest closed.
24 January 1997	Public consultation submissions closed.
29 January 1997	Public submissions received were presented to the Council.
10 February 1997	The franchise agreement and tender documents were presented to and approved by the Council. Councillors voted to call for tenders for the franchise.
14 March 1997	Tenders closed.
19 March 1997	Four tenderers briefed the Council.
24 March 1997	The Council decided to accept United Water’s tender.
23 April 1997	The Council and United Water signed the franchise agreement.
1 July 1997	United Water commenced delivery of water and wastewater services.

- 247 According to Council officers, a benefit of completing the franchise during the 1996-97 financial year, rather than later, was the ability to attract a higher premium component in the franchise fee.

### *Commentary*

- 248 Local authorities should be aware that, in the future or in different circumstances, tenderers might be less willing to pay a premium for such franchise arrangements. Consequently, the focus should be on taking sufficient time to ensure maximisation of all of the other benefits which franchising can provide.
- 249 It is advisable for local authorities to invest time in the development of clear expectations about what they hope to achieve in setting up an alternative method for delivery of their services. Issues to be carefully considered include:
- ↓# required levels of service delivery;
  - ↓# expectations about service delivery;
  - ↓# expectations as to which generation pays for what; and
  - ↓# how assets are to be maintained.
- 250 Time invested at the pre-tender stage should be rewarded with a sound franchise agreement and monitoring and management mechanisms which will be of benefit to ratepayers and the community.

## **Asset Management Plan**

### *Expectation*

- 251 *We expected that the Council would have completed an Asset Management Plan for the water and wastewater networks, or put in place processes to ensure that an Asset Management Plan would be produced.*<sup>7</sup>
- 252 Three ways in which an Asset Management Plan plays a central role in a successful contractual relationship are:
- ↓# To assess the benefits of each tender, it is necessary to know the quality, quantity and condition of the current services. An inventory of the assets, the current level of service provided and the condition of the networks will aid in the assessment of a suitable franchise.
  - ↓# To monitor whether the franchisee is managing and maintaining the assets and supplying expected levels of service, it is necessary to have a benchmark record of the condition of the assets and the level of service which was being provided before the franchise.

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<sup>7</sup> We would expect all local authorities, as normal management practice, to prepare an Asset Management Plan before entering into a contract of this nature.

↓# To make sure that the assets are returned in a suitable condition, it is necessary to have an assessment of the assets prior to the franchise.

253 The Act and generally accepted accounting practice require the production of clear objectives for each of a local authority's activities and policies. We see this as a requirement to produce management plans. In any case, it is good practice to prepare such plans before franchising the service.

### *Findings*

254 The Council chose not to produce an Asset Management Plan before the franchise agreement was in place. The Council had an asset register and maintenance history records which it felt were sufficient for tenderers to carry out due diligence. In the Council's opinion, the skills and expertise which a specialist water company could apply to development of an Asset Management Plan would produce a better quality plan. We were told that this approach also saved the Council time and money. Council officers told us that the assets were assessed as part of due diligence by all tenderers, and that the assets were found to be "in a median condition for a system of its age and type".

255 The Council included a clause in the franchise agreement requiring United Water to produce an Asset Management Plan to a specified methodology within one year of the start of the franchise (i.e. by June 1998). The plan will then be independently audited by the Council's chosen representative.

### *Commentary*

256 The success or failure of a franchise agreement will depend upon the confidence the local authority has that the franchisee is making sufficient investment in the assets to:

↓# deliver the required levels of service; and

↓# maintain and add to the network as necessary over the period of the agreement.

257 The benefits of preparing an Asset Management Plan are:

↓# *An assessment of the true condition of the assets and current levels of service delivery.* This information reduces the risk for both parties and allows the specification of appropriate terms and conditions for the franchise agreement, as well as appropriate asset quality benchmarks and service delivery standards for the management and monitoring of the contract.

↓# *Sufficient information for potential franchisees to determine a realistic planning and pricing structure with less contingency for risk.* Asset Management Plans improve the level of available information and reduce the risk for both parties. Where insufficient information is available, the franchisee will expect greater returns for the additional business risk which it must bear.

- 258 Asset Management Plans should meet the standards set out in the *New Zealand Infrastructure Asset Management Manual* 1996.
- 259 Water industry standards and technological innovations are continually evolving. All franchise agreements should ensure that the franchisee uses appropriate future techniques and technology.

## Duration of the Agreement

### *Expectation*

- 260 *We expected that the Council would have considered the advantages and disadvantages of different franchise durations to maximise the long-term benefits to ratepayers and the community.*
- 261 Local authorities should consider and document the advantages and disadvantages of different lengths of franchise agreement and how each fits with the objectives for service delivery.

### *Findings*

- 262 Council officers told us that the Council believed that a franchisee would pay a greater fee for an agreement of longer duration. In this context, the Council decided on a 30-year plus 20-year option.

### *Commentary*

- 263 Local authorities need to balance a number of related issues when considering the duration of a franchise agreement. For example:
- ↓# The willingness of the franchisee to invest sufficient capital for the required level of development and maintenance of the assets for the duration of the agreement.
  - ↓# The options for a retail price structure will be affected by the duration of the contract and thus the period within which the franchisee can earn a return.
  - ↓# Where a local authority requests a franchise fee, the duration of the franchise will reflect the potential revenue stream for the franchisee. The longer the duration the greater the potential fee.
  - ↓# A long franchise period runs the risk of the franchisee being able to exploit a monopolistic control of the assets – particularly if a local authority does not ensure that it obtains sufficient information and a power of audit over the franchise agreement.
  - ↓# If the franchise term is too long, alternative companies may simply be unable or uninterested in tendering for the service when it comes up for renewal.

↓# The longer the franchise period the more important it is to identify small differences between tender proposals because the differences will compound significantly over a long-duration contract.

## CONDUCTING THE TENDER

### Chapter Summary

#### *Expectations*

- 301 We expected that the Council would have:
- ↓# Marketed the business opportunity available through the tender in a comprehensive manner.
  - ↓# Carried out the tender process with careful attention to the proper conduct of public business.
  - ↓# Used selection criteria designed to ensure that the franchise agreement meets the long-term interests of ratepayers and water users.

#### *Findings*

- 302 The marketing approach adopted by the Council generated enough interest from suitable tenderers for the tender to be considered a success.
- 303 The tender process was carried out within the terms of the Council's approved procedures.
- 304 Councillors selected the successful tenderer after receiving comprehensive written tenders and hearing oral presentations from the four preferred tenderers and asking appropriate questions of the tenderers and officers. The primary criterion used was the ability of the tenderers to meet the terms of the franchise and tender documents. No documented final selection criteria were used.

### Recommendations

- 305 We recommend that, when a local authority is conducting a tender for franchising a service, it should:
- ↓# Prepare a marketing plan setting out how it intends to maximise exposure of the tender to potential tenderers.
  - ↓# Adopt a range of selection criteria (including both price and non-price attributes) which are designed to ensure that any preferred tenderer will:
    - ≠# meet the strategic objectives for service delivery;
    - ≠# be committed to providing a quality service; and

€# employ innovative and alternative ways to provide the service.

## Marketing

### Expectation

306 *We expected that the Council would have marketed the business opportunity available through the tender in a comprehensive manner.*

307 Good management practice would involve preparing a formal marketing plan, setting out how the Council intended to attract as many potential tenderers as possible – the greater the number of suitable tenderers, the greater the likelihood of meeting more of the long-term interests of ratepayers and water users.

### Findings

308 Council officers marketed the franchise tender. The marketing consisted of:

↓# placing advertisements in all major New Zealand newspapers;

↓# placing advertisements in major Australian newspapers;

↓# placing an advertisement in a national British newspaper; and

↓# faxing copies of the tender advertisement to a large number of British and French water companies.

309 Although no formal marketing plan was produced, the marketing carried out was comprehensive and attracted interest from a number of prospective franchisees.

310 The marketing produced tenderers of the required quality and experience and who were prepared to pay an acceptable fee. Seven tenders were submitted. Accordingly, the tender may be regarded as successful.

## Due Process

### Expectation

311 *We expected that the Council would have carried out the tender process with careful attention to the proper conduct of public business.*

312 For major contracts, a clear record should be kept of all key steps during all stages – to ensure that the process is open and transparent, and to demonstrate that the agreement finally reached between the parties represents best value for the ratepayers.

### Findings

- 313 Our investigations indicated that the tender process was carried out within the procedures approved by the Council.
- 314 The Council's solicitors recommended that all consultation with potential tenderers before tenders closed should be documented. Council officers told us that the Council chose to supply information only on the state of the assets. No other discussions were entered into, so no recording was required.
- 315 The Council was open to tagged bids<sup>8</sup>, but joint venture projects between the Council and the tenderer were rejected as not meeting the tender requirements.

### *Commentary*

- 316 Local authorities should be aware that an absence of records of the various stages in a tender process could expose an authority to criticism that the result may not be in the best public interest nor represent best value for money. In addition, it may leave the authority open to legal action from other tenderers.

## **Selection Criteria**

### *Expectation*

- 317 *We expected that the Council would have used selection criteria designed to ensure that the franchise agreement meets the long-term interests of ratepayers and water users.*
- 318 It is important that local authorities select tenderers based on agreed criteria which are consistent with the strategic objectives for service delivery. The selection criteria should allow tenderers to suggest innovative and alternative options.
- 319 Price is a key criterion. However, non-price attributes can be important factors in choosing a contractor. Collectively, non-price attributes represent the contractor's commitment to quality assurance.

### *Findings*

- 320 The sole stated selection criterion for those invited to make oral presentations to the Council was that they met the terms and conditions of the tender documents and draft franchise agreement.
- 321 All seven tenders were considered by the Council, and oral presentations were made by the four preferred tenderers on 19 March 1997.
- 322 No further documented selection criteria were used to choose the tenderer whose bid was eventually accepted.

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<sup>8</sup> A tagged bid is where a tenderer has assessed a contract or agreement and has highlighted issues which it would like to change or discuss alternatives to those specified in the documents.

323 Council officers told us that Councillors selected the successful tenderer after hearing the four presentations, asking questions about the qualities and strengths of each tenderer, and taking advice from officers.

*Commentary*

324 The inclusion of non-price selection criteria is an opportunity for local authorities to achieve quality assurance, service delivery and other objectives which they should have developed at the pre-tender stage.

325 The evaluation of bids based on the selection criteria should be objective and rigorous especially having regard to the comments in paragraph 258. Councillors should have the benefit of an expert evaluation of the proposals to help them arrive at a final decision 4 they should not decide who will be awarded the contract on a whim or as the result of a “slick presentation”. Few elected representatives have the experience to competently evaluate the differences of detail between alternative bids without such advice.

326 Local authorities should consider documenting the entire decision-making process – including meetings, presentations and question and answer sessions with tenderers – as this will provide further transparency and assurance over the selection process. There is also an increasing legal emphasis on recording the selection criteria used within any tendering process.

## DRAWING UP THE FRANCHISE AGREEMENT

### Chapter Summary

#### *Expectations*

401 We expected that the Council would have ensured that the franchise agreement:

- ↓# Includes clauses with4
  - ≠# incentives for the franchisee to enhance network performance (by reducing water losses and minimising infiltration into the wastewater network), and to meet environmental, water conservation and efficiency objectives; and
  - ≠# provision for the franchisee to bear the costs of water lost in the network between the bulk supply intake and consumers' meters.
- ↓# Allows the franchisee to supply water to a variety of quality, quantity and pressure standards (within minimum regulations) to different users if required.
- ↓# Requires the costs for legal or other professional advice associated with resource consent applications to be borne by the franchisee.
- ↓# Requires the franchisee to meet all legal or third-party water and wastewater quality standards, and to bear the associated costs.
- ↓# Defines clearly all legal responsibilities between the two parties for matters such as: access to properties, trade waste bylaws, issues concerning the Public Works Act 1981, and other responsibilities imposed by the Local Government Act.
- ↓# Sets up specific performance measures for maintenance and renewal of, and additions to, the water and wastewater networks.
- ↓# Requires the franchisee to prepare a set of procedures to deal with a range of extreme events/Acts of God. The Council should itself have a set of such procedures.
- ↓# Requires the franchisee to:
  - ≠# supply the service to a set of minimum standards; and (if warranted)
  - ≠# establish a customer charter, after consultation with its customers, setting out detailed service standards.

- ↓# Includes a mechanism for regulating the prices charged to customers.
- ↓# Includes provisions to encourage the franchisee to provide a system of price differentiation for different classes of consumer.
- ↓# Requires the franchisee to establish rules for customer bonds.
- ↓# Provides for standards for monitoring the accuracy of water meters.
- ↓# Includes:
  - ≠# definitions of poor performance and non-performance by the franchisee; and
  - ≠# mechanisms to deal with those circumstances.

### *Findings*

- 402 The franchise agreement contains provisions relating to all of our expectations.
- 403 Council officers told us that the franchise agreement is deliberately worded to encourage an innovative approach to service delivery. At the same time, they feel that the wording is directive and capable of clear interpretation to reflect the standards existing at any time.
- 404 The franchise agreement met the majority of the objectives which it was set up to achieve. (See paragraphs 235-239.)
- 405 The price of water and wastewater is fixed for the first two years of the franchise. After July 1999, United Water can charge the Auckland Average Price for water. If United Water does choose to do this, it will mean an increase in the price of water for Papakura residents who before the franchise agreement paid the lowest price for water in the region.
- 406 The price structure provides an incentive for United Water to minimise network losses.

### **Recommendations**

- 407 We recommend that, when a local authority is drawing up a franchise agreement, it should:
  - ↓# Ensure that the agreement is designed to meet the objectives for delivery of service.
  - ↓# Have regard to the expectations set out in the Appendix on pages 59-63. In particular, it should give consideration to:

- ≠ identifying the long-term interests of the ratepayer and structuring the agreement to protect them;
  - ≠ price control; and
  - ≠ the authority's role and responsibilities to monitor customer satisfaction, service quality, asset maintenance, and non-performance by the franchisee.
- ↓# Set clear standards to ensure that the franchisee knows what it is expected to do, and to provide an objective basis for managing the agreement to the level of assurance required.
  - ↓# Ensure that the agreement requires the franchisee to set up a customer charter which covers a specified range of issues. The charter should have regard to the customer agreement guidelines issued by the Association of Local Government Engineers of New Zealand (ALGENZ).<sup>9</sup>

## Network Losses

### *Expectations*

408 *We expected that the Council would have ensured that the franchise agreement includes clauses with:*

- ↓# *incentives for the franchisee to enhance network performance (by reducing water losses<sup>10</sup> and minimising infiltration into the wastewater network), and to meet environmental, water conservation and efficiency objectives; and*
- ↓# *provision for the franchisee to bear the costs of water lost in the network between the bulk supply intake and consumers' meters.*

### *Findings*

409 The franchise agreement contains clauses and a pricing formula which encourage United Water to reduce water losses from the water supply network and infiltration to the wastewater network. The pricing formula is such that all water that is lost must be paid for by United Water. This is a direct incentive for United Water to improve the networks and reduce losses.

410 The agreement also includes a clause which requires United Water to be “vigilant” in checking for leakage, and to take preventative steps promptly.

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<sup>9</sup> *Customer Agreement Guidelines for Water Services*, December 1997.

<sup>10</sup> Losses are defined as the total water received from the bulk supplier less water used for scouring, firefighting and recorded on customers' meters. Losses are also referred to as “leakage” and “unaccounted water”.

## **Variable Quality, Quantity and Pressure**

### *Expectation*

- 411 *We expected that the Council would have ensured that the franchise agreement allows the franchisee to supply water to a variety of quality, quantity and pressure standards (within minimum regulations) to different users if required.*

### *Findings*

- 412 The franchise agreement allows United Water to supply different qualities or quantities within the boundary of specified third-party standards.
- 413 United Water will supply on alternative bases if the market demand is sufficient.

## **Resource Consent Costs**

### *Expectation*

- 414 *We expected that the Council would have ensured that the franchise agreement requires the costs for legal or other professional advice associated with resource consent applications to be borne by the franchisee.*

### *Finding*

- 415 The franchise agreement provides that all costs associated with resource consents are the responsibility of United Water.

## **Third-party Standards**

### *Expectation*

- 416 *We expected that the Council would have ensured that the franchise agreement requires the franchisee to meet all legal or third-party water and wastewater quality standards, and to bear the associated costs.*

### *Finding*

- 417 The franchise agreement specifically requires United Water to meet and pay for compliance with all relevant third-party standards.

## Legal Responsibilities

### Expectation

418 *We expected that the Council would have ensured that the franchise agreement defines clearly all legal responsibilities between the two parties for matters such as: access to properties, trade waste bylaws, issues concerning the Public Works Act 1981, and other responsibilities imposed by the Local Government Act.*

### Findings

419 The franchise agreement requires United Water to do everything necessary to comply with legislation. For those elements for which it cannot transfer responsibility, the Council will undertake compliance on behalf of United Water.

420 The agreement also indemnifies the Council for any loss which it may suffer as a result of a breach by United Water.

## Maintenance Performance

### Expectation

421 *We expected that the Council would have ensured that the franchise agreement sets up specific performance measures for maintenance and renewal of, and additions to, the water and wastewater networks.*

422 The success or failure of a long-term franchise is influenced significantly by the franchisee making adequate provision to ensure that the networks are maintained in good condition. For this reason, a sound asset management strategy for maintenance and renewal of, and additions to, the networks is of central importance to long-term protection of the interests of ratepayers and users. There are key issues of equity, environmental protection, and water conservation which are dependent upon the franchisee maintaining the networks to the required level.

### Findings

423 The franchise agreement addresses this expectation with requirements that United Water must:

↓# Maintain the assets to an overall standard better than the initial condition.

↓# Extend, modify, replace and repair the assets in order to provide an effective potable water and wastewater service.

↓# Keep the system in good operational order, repair and condition having regard to the initial condition.

↓# Ensure a minimum of a B grade standard for water distribution networks as prescribed by the Minister of Health.

424 The franchise agreement requires both parties to agree on the initial condition. This is being established by United Water as part of its preparation of an Asset Management Plan in accordance with a methodology set out in the agreement. If there is disagreement as to the establishment of the initial condition, that can be resolved under the dispute resolution conditions of the agreement.

425 Council officers told us that the condition of the assets was assessed as part of the due diligence process by all tenderers, and that all of them found the assets to be “in a median condition for a system of its age and type”. The officers also told us that extensive historical data indicated that there was no deferred maintenance.

426 The franchise agreement requires United Water to produce a report every five years on the condition of the assets, which the Council may have audited by someone independent of the company. The Council’s view is that the regular five-yearly audit is appropriate to confirm assumptions and expectations of the condition of the systems and more frequent assessment of the assets are unnecessary:

↓# because of the costs of such a review; and

↓# because of the nature of the assets (pipes, valves and other components of the infrastructure have characteristics as to their wear and tear, deterioration, etc which are well known to engineers).

427 The Council can require United Water to produce all records, plans and documents which the Council requires for the purpose of ensuring their compliance with the terms of the agreement. In addition, United Water must report all changes to the system within one month.

428 Because the Council had no Asset Management Plan in place when the franchise began, performance measures for the maintenance of the assets will not cover the first year (1997-98) of the franchise.

429 The Council told us that if a major problem was to arise it would become readily known to them by way of public complaint or through the reporting procedures contained in the agreement.

### *Conclusion*

430 Given that<sup>4</sup>

↓# the initial condition of the assets has yet to be determined;

↓# an Asset Management Plan will not be available until June 1998; and

↓# no substantial maintenance has yet been carried out under the franchise agreement<sup>4</sup>

we cannot at this time judge whether the requirement in the franchise agreement for a five-yearly audit will provide satisfactory assurance that the assets are being suitably maintained. This is an issue that we will look at again in our follow-up audit.

### *Commentary*

- 431 Local authorities should assure themselves that contracts for service delivery of this nature require the franchisee to invest sufficient ongoing capital and technical expertise for:
- ↓# preservation of the assets;
  - ↓# performance of the service to required standards; and
  - ↓# provision of capacity to meet future demand.
- 432 Local authorities should define the standards to which assets have to be maintained. Clear standards ensure that the franchisee knows what is expected of them, and provide an objective basis for managing the agreement. Standards that are unambiguous reduce the potential for dispute between an authority and a contractor over interpretation of satisfactory performance.
- 433 The existence of an Asset Management Plan before establishing the franchise provides a platform for local authorities to set realistic standards in the franchise agreement for maintenance, additions to the network and customer service.
- 434 The agreement should require the franchisee to comply with industry standards in its methodology or condition and performance assessment. Such standards are currently only in their infancy in New Zealand. However, it is inevitable that, over the period of the Papakura agreement for example (30-50 years), detailed standards will develop. If a local authority wishes to be able to more effectively benchmark the activities of the franchisee, it should require the franchisee to meet such industry standards as they are developed.
- 435 Local authorities should ensure that the franchise agreement contains sufficient detail about the proposed asset management system that will be used. Some very sophisticated systems are now available which will provide a comprehensive and essential management tool for asset management. The New Zealand water industry, through the auspices of ALGENZ and the New Zealand Waste Water Association, is promoting the use of a single system to form the basis of meaningful industry benchmarking.
- 436 An agreement containing only broad standards increases the risk of dispute over the interpretation and implementation of maintenance standards. “Descriptive” grading systems (such as those detailed in the Papakura agreement) are vulnerable, to some extent, to the subjectivity of the assessor.

- 437 Asset assessment is an ongoing process, with assumptions and decisions on asset condition being made on a continual basis. The longer the periods between auditing the condition of the asset, the greater the risk that the same individuals will not carry out each assessment. This dilutes the quality assurance which monitoring can provide.
- 438 Clear and specific definitions of maintenance performance are a more objective means for managing and enforcing the terms of the agreement.

## Extreme Events

### *Expectation*

- 439 *We expected that the Council would have ensured that the franchise agreement requires the franchisee to prepare a set of procedures to deal with a range of extreme events/Acts of God. The Council should itself have a set of such procedures.*
- 440 Local authorities should ensure that all responsibilities and procedures for both parties are clear for a range of extreme events – earthquake, drought, flooding, fire, dam failure and company failure<sup>11</sup>. This is in the interests of both parties.
- 441 Depending on the terms of the franchise agreement, local authorities will still need a set of guidelines and procedures for responding to a range of extreme events 4 because they will have residual responsibilities in the franchise situation.

### *Findings*

- 442 The franchise agreement requires United Water to produce a Disaster Recovery Plan by 30 June 1998. The plan is to be reviewed and updated as necessary every five years.
- 443 The Disaster Recovery Plan is required to contain:
- ↓# Risk analysis of possible loss or damage.
  - ↓# Analysis of insurance required.
  - ↓# Plans for disaster relief and temporary service.
  - ↓# Short-, medium- and long-term reconstruction plans.
- 444 Company failure is an event that can be dealt with under the termination clause of the agreement.
- 445 No contingency procedures are currently in place.

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<sup>11</sup> By company failure, we mean insolvency or any form of company collapse.

## Commentary

- 446 Good management practice and the requirements of section 247D(d) of the Local Government Act mean that local authorities should assess and account for these types of risk when considering the advantages and disadvantages of the alternative approaches to service delivery.
- 447 Local authorities should give due consideration to the seismic performance of any structures when assessing serviceability and prioritising investment needs. In similar exercises undertaken in other parts of New Zealand, one of the principal justifications claimed for asset replacement or upgrade has been the assessed inability of key components to adequately resist earthquakes. Water reservoirs and their connections, pump stations, tanks, pipe bridges and mechanical equipment are particularly vulnerable.

## Customer Service Standards and Customer Charter

### Expectation

- 448 *We expected that the Council would have ensured that the franchise agreement requires the franchisee to:*
- ↓# *supply the service to a set of minimum standards; and (if warranted)*
  - ↓# *establish a customer charter, after consultation with its customers, setting out detailed service standards.*

### Findings

- 449 The franchise agreement states a range of customer service standards in general terms, but United Water's practice is to establish a charter defining the relationship between the supplier and the customer.
- 450 The franchise agreement requires United Water to establish an agreement with its customers (a customer charter).
- 451 The customer charter provision was included at the suggestion of United Water and was supported by the Council.

## Commentary

- 452 As an alternative to the franchise agreement specifying detailed customer service standards, the agreement could contain a clause to require the franchisee to set up a comprehensive customer charter that meets minimum standards specified in the agreement. Any charter should have regard to the ALGENZ *Customer Agreement Guidelines for Water Services*.

- 453 A customer charter provides more flexibility for agreeing and updating customer service standards than specifying such standards in the franchise agreement.
- 454 Local authorities should consider specifying a range of clearly defined unambiguous service delivery standards, performance standards or customer charter standards within an agreement designed to reduce the potential for disputes over interpretation of satisfactory performance (see also paragraphs 483-496).

## Price Regulation

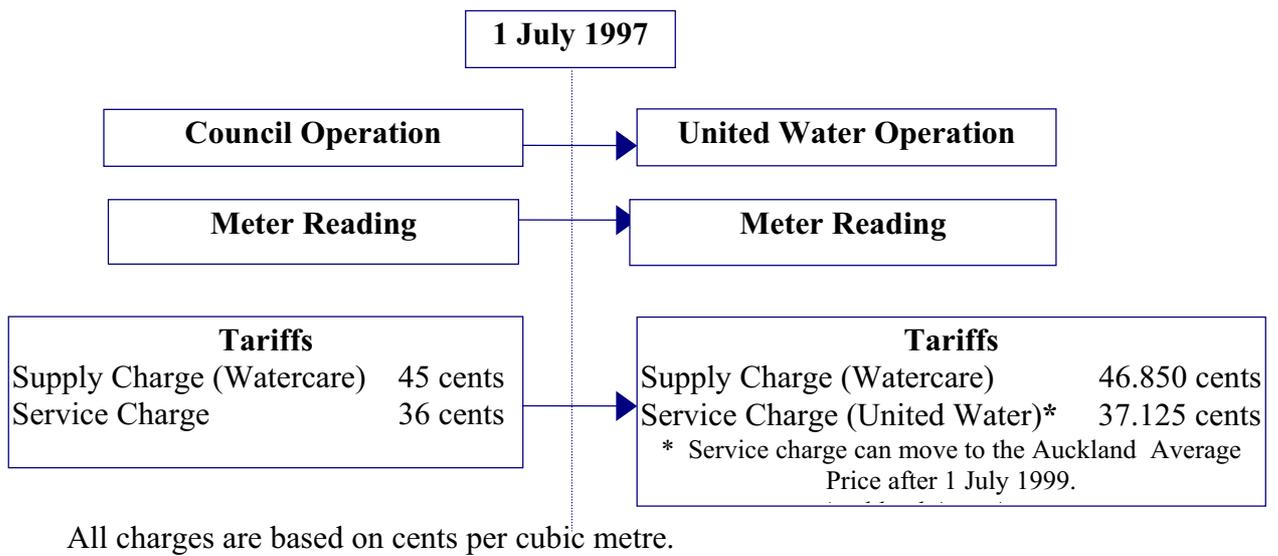
### *Expectation*

- 455 *We expected that the Council would have ensured that the franchise agreement includes a mechanism for regulating the prices charged to customers.*
- 456 Given the monopolistic nature of a public utility franchise, controls need to be in place to prevent unreasonable price increases for customers.

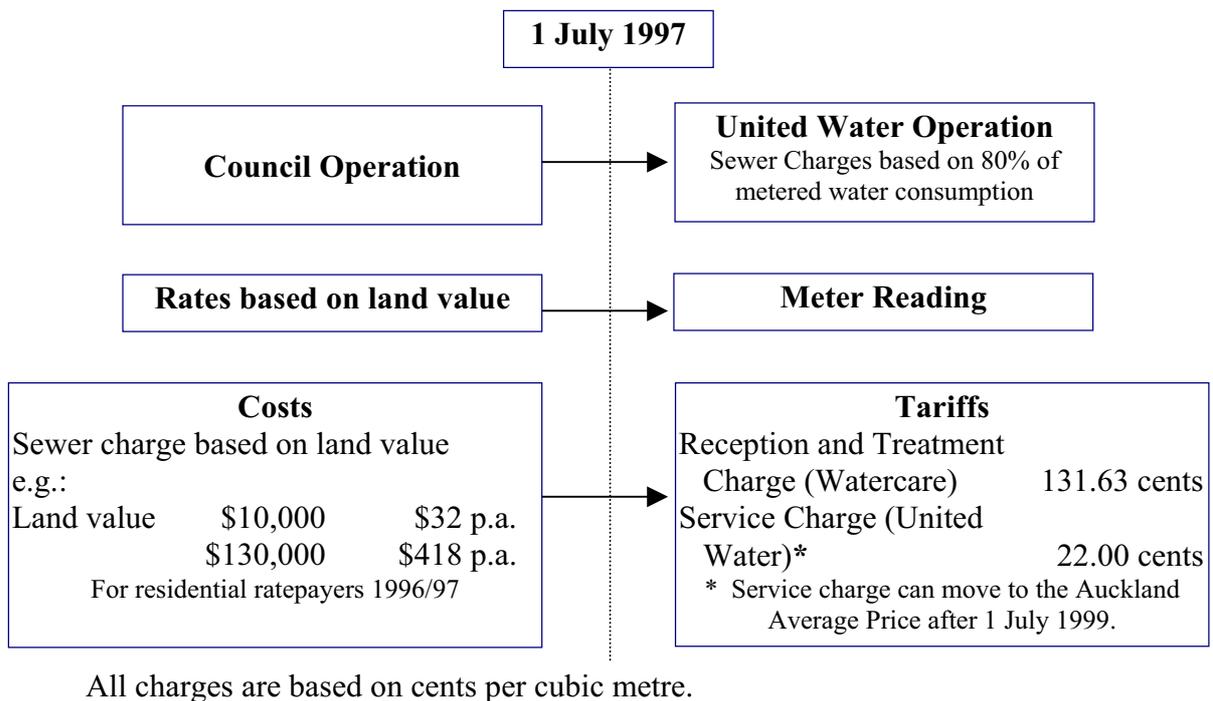
### *Findings*

- 457 Before the franchise agreement, the Council's service charges for water and wastewater were the lowest in the region.
- 458 Within the agreement, there are two pricing mechanisms – one for water supply and the other for wastewater disposal. The United Water component of the price – the service charge – is fixed for the first two years of the franchise (i.e. until 1 July 1999).
- 459 Water consumers pay two charges (see Figure 4 on page 42):
- ↓# a supply charge, based on metered consumption to cover the cost of the treated water which United Water buys from Watercare; and
  - ↓# a service charge, determined by United Water to pay for delivery of water and maintenance of the water supply network.
- 460 Similar charges are imposed for sewerage (see Figure 5 on page 42):
- ↓# a reception and treatment charge, to cover the bulk removal and treatment costs incurred from Watercare; and
  - ↓# a service charge, determined by United Water for maintenance of the wastewater network based on 80% of metered water.

**Figure 4**  
**Changes to Water Charges**



**Figure 5**  
**Changes to Wastewater Charges**



- 461 After July 1999, United's charges are restricted to being at or below the Auckland Average Prices for water and wastewater services.
- 462 The bulk supply component of the price for both water and wastewater disposal is passed directly from the wholesaler, Watercare in this case, on to the consumer. United Water does not charge any additional handling or administration fee. There is

also a requirement for United Water *to do all things necessary* to ensure that the price of bulk water supply is *at all times minimised*. Should other competition come into play, then the agreement provides that the charge to be made is the average charge by Watercare and any other wholesalers.

463 One of the Council's stated objectives of entering into the franchise was to protect the interests of its ratepayers by *locking in the current low cost regime* (December 1996). If, in 1999, United Water does charge the Auckland Average Price for its service, it will mean an increase of prices for all Papakura consumers from the lowest in the region to the Auckland Average Price.

464 We were told that the Council believed that:

↓# While the prices were the lowest in the region before the agreement, this was a fragile situation, as the small scale of the Papakura system precluded the economies of scale available to larger local authorities. Consequently, there was no guarantee that Papakura would remain at the lowest-price.

↓# It is now able to guarantee that Papakura prices will always be at or below the Auckland Average Price.

↓# By introducing an additional company (United Water) into the region the Council had introduced competition into the regional water supply and wastewater industry.

↓# United Water could take up the business opportunity available to develop an alternative water supply and/or wastewater treatment plant in Papakura and perhaps supply these services at a cheaper rate than Watercare.

↓# This could then encourage Watercare to improve the efficiency of its operations and pass any economies on to consumers in the form of lower bulk charges.

↓# While it cannot dictate the charging policy of bulk water supply through the agreement with United Water, there are legal remedies in the regulatory arena controlling monopolies. *In this regard water and wastewater charges are no different from other natural monopolies such as the supply of energy and telecommunication services. As a matter of public policy, the general law as expressed in the Commerce Act 1986 should prevail and govern the charging methodology of bulk suppliers.*

### Conclusions

465 The franchise agreement meets our expectation of including a mechanism for regulating the prices charged to customers.

466 However, we have some concerns about the pricing mechanism. These are that:

- ↓# Although the two-year price freeze in the agreement keeps the service charges low until July 1999, it is uncertain whether this position will be maintained after that time when United Water can increase charges up to the Auckland Average Price. Our concern is that such a price movement would fail 4 in the longer term 4 to meet the Council's objective to *protect the interests of its ratepayers by locking in the current low cost regime*.
- ↓# The agreement provides no protection against the potential inefficiencies of other councils in the Auckland area that are reflected in their price for water and, consequently, in the Auckland Average Price.
- ↓# The agreement provides no protection against United Water's ability to influence the Auckland Average Price should it secure a contract to deliver water and/or wastewater service to one or more of the other local authorities in the area.
- ↓# The agreement does not require United Water to develop alternative water supply or wastewater treatment systems; nor to pass on any benefits should it choose to do so. Therefore, the extent of any efficiency gains to be derived from the innovative approach available to the company (and the resulting introduction of competition into the market) remains a matter for speculation.

467 Consequently, we find it difficult to assess whether consumers will obtain any benefit from increased efficiencies in service delivery 4 which the franchise agreement allows for, and which the Council hopes will be gained. The "average price" may well be appropriate to allow the necessary investment for the maintenance and improvement of the asset over the long term, but at this time we cannot judge if this is the case. The concerns outlined in paragraph 466, and what benefits the consumers may obtain from the franchise agreement, are issues that we will consider as part of our follow-up audit.

### *Commentary*

468 The condition of the assets is directly linked to the profitability which any pricing structure will provide for a franchisee. Council officers told us that the due diligence carried out by the tenderers indicated that the water and wastewater network was in neither a very good nor a poor condition but is "median". The officers also told us that there was no deferred maintenance and that appropriate capital investment had been made in the system.

469 In developing a pricing structure for a franchise agreement, local authorities should take into account the need to balance a number of issues. Authorities need to consider the long-term capital investment that will be necessary by a franchisee, balanced against any short-term agreements about the unit retail price for water. Regional variations relating to the nature and size of the system will also affect the types of running costs involved, which in turn will affect the determination of an appropriate pricing structure.

470 An appropriate pricing structure, and how it meets the full range of service delivery expectations and long-term interests of the community, will be central to the success of any franchise agreement. Local authorities should be careful that in attempting to control price at too low a level they are not disadvantaging long-term users of the service.

## **Price Differentiation**

### *Expectation*

471 *We expected that the Council would have ensured that the franchise agreement includes provisions to encourage the franchisee to provide a system of price differentiation for different classes of consumer.*

472 There is a range of potential benefits for both water users and the franchisee in setting up a system which allows price variation. The franchise agreement should not preclude this option.

### *Findings*

473 The franchise agreement allows for price differentiation between classes of consumer after two years.

## **Customer Bonds**

### *Expectation*

474 *We expected that the Council would have ensured that the franchise agreement requires the franchisee to establish rules for customer bonds.*

### *Findings*

475 The franchise agreement has no provisions covering customer bonds.

476 However, arrangements for customer bonds are covered in the customer contract.

### *Commentary*

477 This expectation could be met within the terms and conditions of a customer contract or charter if that approach was preferred.

## **Accuracy of Water Meters**

### *Expectation*

478 *We expected that the Council would have ensured that the franchise agreement provides for standards for monitoring the accuracy of water meters.*

## *Findings*

- 479 The franchise agreement allows for water meters to be treated as accurate, but requires United Water to check the accuracy at the request of customers.
- 480 The customer contract provides that water meters will be regularly checked by United Water.
- 481 A customer who requests a check is charged a testing fee if the meter reading is found to be accurate. No charge is made if the meter reading is found to be inaccurate.

## *Commentary*

- 482 The specific terms and conditions of a customer contract or charter are also an appropriate mechanism to deal with this issue, as part of the day-to-day operation of the service.

## **Poor Performance and Non-performance by the Franchisee**

### *Expectation*

- 483 *We expected that the Council would have ensured that the franchise agreement includes:*

↓# *definitions of poor performance and non-performance by the franchisee; and*

↓# *mechanisms to deal with those circumstances.*

- 484 It is important that local authorities have appropriate means of legal redress in the event of the franchisee failing to meet the terms and conditions of the franchise agreement. In addition, the public should be protected from business failure by the franchisee.
- 485 Both parties should have the benefit of clear definitions of what constitutes poor performance or non-performance by the franchisee, and the penalties accruing should the circumstances occur. Such definitions provide an objective basis for managing the franchise agreement and help to minimise the potential for dispute between an authority and the franchisee over interpretations of satisfactory performance.

## *Findings*

- 486 The franchise agreement gives the Council the right to monitor water quality, asset management, prices charged, and service performance.
- 487 The franchise agreement requires United Water to:

- ↓# Operate the assets in an efficient and effective manner so that customers serviced by the assets, and paying for such services, may expect a level of service and quality of supply in accordance with accepted industry standards prevailing at the relevant time in the Auckland Area.
- ↓# Ensure a continuity of supply of good quality, wholesome, potable water to Papakura District.
- ↓# Use its best endeavours to maintain good working relations with customers, fellow citizens (both corporate and individual) and regulating authorities.

488 The Council's view is that:

- ↓# these provisions, along with other obligations, are broad and comprehensive;
- ↓# *the nature of the agreement is one where it is expected that interpretation will change from time to time to reflect the social and legal environment within which the agreement is operating; and*
- ↓# *the wording is directive and capable of clear interpretation reflecting the standards existing from time to time; and that, as a result*
- ↓# *it is undesirable to prescribe standards that are likely to become inappropriate and render nugatory consumer law and monopoly practices controlled under the Commerce Act 1986 or general community expectations that are likely to change over the life of the agreement; and*
- ↓# all aspects of the franchise agreement can be changed by mutual agreement at any time during the franchise. Council officers told us that the franchise agreement was likely to evolve as the relationship with United Water matured, and that the detail of the contract in 5 years' time could be quite different from its current form.

489 The Council's view is that the dispute resolution processes set out in the franchise agreement is a mechanism by which the Council can clarify or address low level issues and resolve poor or non performance issues.

490 In the event of poor performance or non-performance by United Water the "disciplinary" provision in the agreement is a termination clause. This can be invoked principally on the grounds of non-compliance with agreed obligations or the directions of an arbitrator following the dispute resolution process.

### Conclusions

491 The agreement meets our expectation that there will be a definition of poor performance and non-performance, and that there is a mechanism to deal with those circumstances.

492 The Council’s approach was, wherever possible, to encourage innovation, negotiation, partnership and self-regulation, rather than being over-prescriptive about management and control. There are known difficulties in proving poor performance within a facilities management contract, and in terminating a contract when poor performance is sufficient to compromise customer satisfaction but not bad enough to invoke termination procedures.

493 We cannot assess:

↓# how effective the “broad” approach taken by the Council will be; or

↓# the potential benefits or disadvantages of letting a 50-year contract and then continuing to renegotiate it throughout its term.

We will look at these issues as part of our follow-up audit.

494 The terms of the customer charter oblige United Water to monitor its service performance for individual customers, and to provide redress for failure to meet certain standards. While this requirement is a commendable feature in its own right, we believe that it is no substitute for what is needed to protect the interests of the Council, ratepayers and consumers generally.

### *Commentary*

494 Excessive monitoring would defeat the purpose of setting up a franchise agreement like the Papakura agreement which is intended, as far as possible, to be self-monitoring. While self-monitoring may be a desirable feature, the ultimate monitoring responsibility will always lie with the local authority.

495 In identifying key factors that will indicate poor performance or non-performance and allow the authority to enforce its requirements, a balance needs to be struck between obtaining sufficient assurance minimising day-to-day interference or regulation of the franchisee.

496 Other alternatives – such as specific performance requirements and sliding scales of penalties – offer more specific, directive and enforceable options. These can be regularly reviewed to ensure their relevance to accepted standards at the time. They could also be linked to any customer charter that builds a direct relationship between the franchisee and the customer while ensuring that primary liability lies with the franchisee.

## MANAGING AND MONITORING THE FRANCHISE

### Introduction

501 Where a local authority's assets are maintained under contract, it must manage the contract so as to:

↓# meet its own service commitment to the ratepayers; and

↓# ensure that the assets are managed in a suitable manner for the long term.

The authority should allocate adequate resources (either staff or contractors) and establish systems to perform this role.

502 Public concern over any change in the responsibility for operation and management of the service is likely to persist until considerably more experience with alternative service delivery options has been gained. In particular, allaying public concern will depend upon objective information on the benefits or disadvantages that result from alternative systems of delivery. In this climate, the development of (and systematic reporting against) appropriate performance standards must be a priority for any authority which adopts alternatives to the traditional method of service delivery.

503 When a local authority is developing options for delivery of services, it should consider carefully what level of control it requires. This would then be reflected in the type of agreement which the authority would set up to deliver the services. Performance measures and monitoring are an effective way of providing the necessary level of assurance to ensure protection of the assets and the long-term public interest.

504 The more restrictive and specific the agreement is, then the greater will be the level of assurance – but the incentives for innovation and possible cost savings will be less. The less restrictive and specific the agreement is, then the greater will be the possibility for innovation and savings – but the risks inherent in the arrangement will also be greater.

### Chapter Summary

#### *Expectations*

505 We expected that the Council would have:

↓# Allocated suitable resources and established the necessary systems to manage and monitor United Water's performance under the franchise agreement and, in particular, the company's adherence to the customer service provisions of the customer charter.

- ↓# Ensured that it has access to sufficient information from United Water to allow it to assess, validate and audit the company's performance.
- ↓# Put in place procedures and performance specifications to enable it to monitor maintenance and renewal of, and additions to, the assets during the franchise.
- ↓# Put in place procedures to enable it to monitor customer service and quality assurance performance during the franchise.
- ↓# Created procedures for dealing with poor performance or non-performance by the franchisee.
- ↓# Created procedures for assessing the required condition of the assets to be returned to its control at the end of the franchise.
- ↓# Put in place procedures for regular communication with the franchisee.

### *Findings*

- 506 In April 1997, the Council established a Monitoring Committee to monitor all contracts – including the water and wastewater franchise.
- 507 In the 1997-98 Annual Plan, objectives have been established for monitoring the franchise agreement. Monitoring procedures must be in place by 30 June 1998.
- 508 The Monitoring Committee has yet to establish monitoring systems to specify information requirements from United Water.
- 509 The Monitoring Committee has met once since it was formed. It did not address any issues to do with the franchise agreement. No minutes were taken and it did not report back to a meeting of the full Council.
- 510 The franchise agreement allows the Council to have access to all reports and data produced by United Water which are necessary to monitor the franchise.

### **Recommendations**

- 511 We recommend that, when a local authority is determining how to manage and monitor a franchise, it should:
  - ↓# Establish the necessary systems and allocate suitable resources to manage and monitor the franchise from its commencement.
  - ↓# Implement a programme of auditing the performance of the franchisee to provide the level of assurance it requires. The programme should incorporate risk-based audits, systematic inspections of work quality, and periodic reviews of the franchisee's quality control systems. Where possible, the auditing

function should be integrated with the monitoring of asset condition, and the results of audits documented to provide a record of contractor performance and a source of data for future retendering.

- ↓# Develop an Asset Management Plan which establishes clear benchmarks of existing asset condition and service levels. This will provide a sound basis to develop clear procedures for:
- ≠# dealing with poor performance or non-performance by the franchisee;
  - ≠# assessing the required condition of the assets before they are returned to the authority's control at the end of the franchise;
  - ≠# dealing with a range of extreme events; and
  - ≠# communicating with the franchisee as a basis for ongoing administration of the franchise.

## Resources

### *Expectation*

- 512 *We expected that the Council would have allocated suitable resources and established the necessary systems to manage and monitor United Water's performance under the franchise agreement and, in particular, the company's adherence to the customer service provisions of the customer charter.*
- 513 When local authorities contract out services they need to have access to the resources, skills and experience required to manage and monitor the contracts they enter into. The scale of need increases as the scope and complexity of the contract increases.

### *Findings*

- 514 The Council formally established a Monitoring Committee on 14 April 1997 to monitor all contracts – including the water and wastewater franchise.
- 515 The Council's former Director of Works is currently under contract to chair the Monitoring Committee and to supply engineering consultancy services to the Council.
- 516 We were told that the Monitoring Committee had met once (in August 1997), but had yet to meet to discuss the water and wastewater franchise issues. No evidence could be produced to us of the committee having met or reported back to a meeting of the full Council.
- 517 The Council's Chief Executive is in the process of establishing with United Water the monitoring procedures required under the franchise agreement. At the time of carrying out the audit the exact requirements had yet to be established.

- 518 Annual Plan objectives have been established for monitoring the franchise agreement. Monitoring procedures must be in place by 30 June 1998.

## Information

### *Expectation*

- 519 *We expected that the Council would have ensured that it has access to sufficient information from United Water to allow it to assess, validate and audit the company's performance.*
- 520 Local authorities need to have access to information on the management and operation of the service in order to:
- ↓# protect the long-term interests of ratepayers;
  - ↓# monitor the level of customer service; and
  - ↓# reduce the risk of a franchisee exploiting the agreement or the assets.
- 521 Local authorities also need to have access to information that will enable them, in due course, to retender the service – either in the event of default during the term of a franchise agreement or at the renewal date.
- 522 Local authorities should also be able to assure themselves that the performance of franchisees is acceptable in relation to both the standards set in the franchise agreement and relevant industry standards.
- 523 Information for monitoring purposes needs to be accurate and relevant, and should be based upon the Asset Management Plan and specific service requirements specified in the franchise agreement.

### *Findings*

- 524 The franchise agreement allows the Council to have access to all of United Water's data and records which enable the Council to meet its monitoring requirements.
- 525 The franchise agreement requires United Water to produce to the Council:
- ↓# monthly water quality reports;
  - ↓# as-built plans of upgrades or modifications to the assets;
  - ↓# an annual report on water costs<sup>12</sup>;

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<sup>12</sup> To establish that the unit prices for water and wastewater charges do not exceed the Auckland Average Price, and that bulk water costs are being fairly passed on to the customers.

↓# an annual report on solvency; and

↓# a five-yearly report on the condition of the assets.

526 At the time of the audit the Council had not specified the full range of the information which it requires from United Water to conform to these requirements.

527 The Council has yet to develop a technical process to audit or analyse any information it receives from United Water.

### *Commentary*

528 The ability of the Council to meet its monitoring requirements relies largely on United Water producing the data and reports required by the franchise agreement.

529 As procedures for the supply, collection, analysis and storage of information are central to the ability of local authorities to manage and monitor franchise agreements, requirements and procedures should be established for:

↓# timely provision of relevant information; and

↓# independent verification of information to assess the “true” picture at any time.

## **Monitoring Maintenance**

### *Expectation*

530 *We expected that the Council would have put in place procedures and performance specifications to enable it to monitor maintenance and renewal of, and additions to, the assets during the franchise.*

531 It is essential that the assets belonging to services contracted out are maintained to a suitable standard and capacity throughout the term of the contract. In the case of water and wastewater services, particularly, the long-term health and financial effects on the public could be significant if the assets are allowed to deteriorate. Consequently, local authorities need to monitor and audit the quality of maintenance to ensure that the condition of the assets is maintained.

532 Asset inspections enable a local authority to review the contractor’s work schedules against the maintenance needs of the assets and the priorities of the authority. As such, condition monitoring provides an empirical basis for ongoing maintenance. Monitoring changes in the condition of the assets also provides a basis for measuring the performance of the contractor.

533 An auditing programme might consist of:

↓# inspection of work quality against standards and specifications;

- ↓# targeting audits to address identified risks; and
- ↓# periodic reviews of the contractor's quality systems against standard specifications.

534 Where an authority has entered into a "performance", "output" or "total maintenance management" contract – whereby the contractor's performance is judged by the assessed condition of the authority's assets – regular inspections are an indispensable part of contract supervision.

### *Findings*

535 Procedures and performance specifications for the Council to monitor maintenance of the assets are set out in the franchise agreement.

536 The Council's monitoring will take place through:

- ↓# monthly water quality reports and as-built plans (see paragraph 525);
- ↓# the 5-yearly report on asset condition; and
- ↓# customer complaints.

537 The Council may choose to audit United Water's five-yearly report on the condition of the assets.

538 The Council has yet to determine these monitoring arrangements. It plans to do so by June 1998.

### *Commentary*

539 The general asset management strategy as detailed by the agreement will be adequate only if what is proposed to be done is in fact done. Ideally, the monitoring arrangements should have been in place from 1 July 1997.

540 If the Council is to have confidence in the integrity of the maintenance procedures, it will need to develop sound audit mechanisms to validate the accuracy of the asset condition and performance indicators, and will need to commit continuous resources to monitoring. Given the importance and duration of the franchise, monitoring arrangements need to be sound enough to ensure their consistency and effectiveness throughout the term of the franchise.

541 Local authorities should be aware (from very early in the planning process) that the level of assurance which can be provided by monitoring is related to the accuracy of, and relationship between:

- ↓# the Asset Management Plan;

- ↓# the objectives of the franchise agreement;
- ↓# the specific service delivery and technical standards expected of the franchisee; and
- ↓# the information required and provided by the franchisee.

## **Monitoring Customer Service**

### *Expectation*

- 542 *We expected that the Council would have put in place procedures to enable it to monitor customer service and quality assurance performance during the franchise.*
- 543 Local authorities need to be able to assess the quality of customer service throughout the contract to ensure that the level of service provided is satisfactory.
- 544 Authorities can also expect a contractor to have in place management systems for tracking jobs, scheduling work and ensuring that quality assurance procedures are followed. Being able to rely upon the quality assurance systems of the contractor is a key feature of any long-term partnership between an authority and a contractor, and of the effort required to supervise the contract.

### *Findings*

- 545 The Council has no procedures enabling it to monitor, or to require United Water to report on, customer service and quality assurance standards.
- 546 Council officers told us that they have the capacity to monitor customer service performance through the Council's regular customer satisfaction survey.

### *Commentary*

- 547 While use of a customer satisfaction survey can assist accountability, it should not be relied on to the exclusion of other forms of accountability.

## **Poor Performance and Non-performance Procedures**

### *Expectation*

- 548 *We expected that the Council would have created procedures for dealing with poor performance or non-performance by the franchisee.*
- 549 Local authorities will be responsible for ensuring that the public interest is protected in the event of poor performance or non-performance by a franchisee. Authorities

should have guidelines and procedures for dealing with a variety of poor performance or non-performance – ranging from failure to meet minor quality standards through to total business failure.

### *Findings*

- 550 The provisions of the franchise agreement for redress in the event of poor performance or non-performance by United Water are the express obligations on the company, in combination with the dispute resolution procedures, arbitration, and finally the termination procedure (if necessary).
- 551 The Council has set out a series of definitions that it believes are broad and comprehensive, and yet also directive and capable of reflecting standards existing from time to time.
- 552 The mechanism for monitoring performance – and therefore identifying poor performance or non-performance – had yet to be established at the time of our audit. The monitoring processes are to be agreed by July 1998.

### *Commentary*

- 553 Based on appropriate provisions in the franchise agreement and (if relevant) the customer charter, a local authority will need to develop appropriate audit systems which will enable it to establish how the franchisee is performing against the terms and conditions of the agreement and specific performance standards.

## **Asset Condition on Return**

### *Expectation*

- 554 *We expected that the Council would have created procedures for assessing the required condition of the assets to be returned to its control at the end of the franchise.*
- 555 Local authorities will need to ensure that, at the end of a period of contracting out, the assets are returned in the required condition. They should have established how this will be done before that time arrives.

### *Findings*

- 556 The franchise agreement specifies reporting requirements covering the asset condition in each of the final five years of the term of the franchise (that is, years 26 to 30 of the initial term and – if the franchise is renewed – years 46-50 of the extended term).
- 557 The Council has yet to establish procedures to ensure that the condition of the assets is assessed at the appropriate time. Given that the first report for this purpose is not due from United Water for another 25 years, the main issue for the Council seems to be to ensure that a record is kept of that fact and of exactly what the report should cover.

## Commentary

558 We emphasise that the ability of local authorities to assess the final condition of the assets on their return will be directly related to:

↓# the quality and accuracy of the Asset Management Plan; and

↓# the information received and auditing which has taken place throughout the duration of the franchise.

## Liaison with the Franchisee

### Expectation

559 *We expected that the Council would have put in place procedures for regular communication with the franchisee.*

560 Effective communications foster a close and productive working relationship between an authority and the franchisee.

561 A successful communications package would include:

↓# a programme for regular communications between the authority and the franchisee; and

↓# provision for each communication to be properly documented, as an agreed basis for ongoing administration of the franchise agreement.

### Findings

562 The Council has not established any formal procedures for regular communication between itself and United Water. However, Council officers told us that since the agreement began they have developed informal procedures for regular communication, such as:

↓# exchange of letters;

↓# meetings on key issues; and

↓# day-to-day oral contact with staff and senior management on various issues.

## APPENDIX

### MODEL EXPECTATIONS FOR A WATER FRANCHISE AGREEMENT

<b><i>Issues and Expectations Steps Before Tendering</i></b>	<b><i>Context</i></b>
<p><b>Issue No. 1 – Strategic Approach</b>  <i>Expectation: The local authority will develop a strategic approach to the delivery of services before considering individual options for particular services.</i></p>	<p>The option to franchise water and wastewater in the context for service delivery. What is the local authority's context for service delivery? What are the community's expectations for water and wastewater help achieve the larger community's goals?</p>
<p><b>Issue No. 2 – Public Consultation</b>  <i>Expectation: The local authority will consult with the public and consider their feedback during the decision-making process.</i></p>	<p>The franchising of water and wastewater is generally a long-term commitment. The local authority should carry out sufficient consultation to ensure the requirements of the Local Government Act 1999 are met and the local community have been sufficiently consulted.</p>
<p><b>Issue No. 3 – Objectives</b>  <i>Expectation: The local authority will develop and publish objectives for management and operation of the water and wastewater system. The objectives will protect the long-term interests of ratepayers and water users.</i></p>	<p>In order to maximise the benefits of adopting a franchise, the local authority should develop objectives for water and wastewater services that should meet the requirements of the Local Government Act 1999. The objectives of options were considered.</p>
<p><b>Issue No. 4 – Time for Preparing to Tender</b>  <i>Expectation: The local authority will manage the tender process so as to allow sufficient time to maximise the benefits for ratepayers and water users.</i></p>	<p>The time invested in the development of an asset management plan will have important ramifications throughout the tender process. A rushed process may restrict the consideration of options. A thorough process may capture of other benefits. The time taken should be balanced to the community and protect the assets.</p>
<p><b>Issue No. 5 – Asset Management Plan</b>  <i>Expectation: The local authority will either complete an Asset Management Plan for the water and wastewater networks, or put in place processes to ensure that a plan is produced.</i></p>	<p>An Asset Management Plan will enable the local authority to:</p> <ul style="list-style-type: none"> <li>## Assess the benefits of each tender against the requirements of the community of service.</li> <li>## Manage and monitor the franchise agreement.</li> <li>## Assess and ensure the quality and condition of the assets.</li> </ul> <p>The Asset Management Plan should meet the requirements of the <i>Infrastructure Asset Management Manual</i> (New Zealand Water and Wastewater Franchise Association, 2010).</p>

<p><b>Issue No. 6 – Duration of the Agreement</b>  <i>Expectation: The local authority will consider the advantages and disadvantages of different franchise durations to maximise the long-term benefits to ratepayers and the community.</i></p>	<p>The duration of the agreement will be a balance between the condition of the assets, the retail price structure, the investment, the potential revenue stream, and the long-term interests of ratepayers and water users.</p>
<b>Conducting the Tender</b>	
<p><b>Issue No. 1 – Marketing</b>  <i>Expectation: The local authority will market the business opportunity available through the tender in a comprehensive manner.</i></p>	<p><b>Context</b>  A successful marketing exercise will attract a wide range of potential franchisees. The possibility of meeting more of the long-term interests of ratepayers and water users through a management practice would involve the development of a clear strategy on how the local authority intends to maximise expenditure.</p>
<p><b>Issue No. 2 – Due Process</b>  <i>Expectation: The local authority will carry out the tender process with careful attention to the proper conduct of public business.</i></p>	<p>The tender process for a franchise agreement should be a fair and open process, as set out in the Local Government Contracting Practices, as set out in the Local Government Contracting Practices.</p>
<p><b>Issue No. 3 – Selection Criteria</b>  <i>Expectation: The local authority will use selection criteria designed to ensure that the franchise agreement meets the long-term interests of ratepayers and water users.</i></p>	<p>It is important for the local authority to select the franchisee that will deliver the service through the delivery of this service. The development of a clear strategy is an opportunity for the local authority to achieve its long-term objectives. Most importantly, the selection criteria should be designed to meet the interests of ratepayers and water users.</p>
<b>Drawing up the Franchise Agreement</b>	
<p><b>Issue No. 1 – Network Losses</b>  <i>Expectations: The agreement will include clauses with:</i>  ↓ # incentives for the franchisee to enhance network performance (by reducing water losses and minimising infiltration into the wastewater network), and to meet environmental, water conservation and efficiency objectives; and  ↓ # provision for the franchisee to bear the costs of water lost in the network between the bulk supply intake and consumers' meters.</p>	<p><b>Context</b>  Suitable performance measures are an incentive for the franchisee to reduce losses and prevent infiltration to the wastewater network. The franchisee to maintain the assets, to adopt a cost-effective system for the customer based on an efficient system.</p>
<p><b>Issue No. 2 – Variable Quality, Quantity and Pressure</b>  <i>Expectation: The agreement will allow the franchisee to supply water to a variety of quality, quantity and pressure standards (within minimum regulations) to different users if required.</i></p>	<p>Water pressure and quality should be maintained to meet the needs of different users. Also, where possible, practicable and affordable, the franchisee should address the different interests of different water users (e.g. residential customers).</p>

<p><b>Issue No. 3 – Resource Consent Issues</b>  <i>Expectation: The agreement will require the costs for legal or other professional advice associated with resource consent applications to be borne by the franchisee.</i></p>	<p>The maintenance and development of the infrastructure and assets which will require the franchisee to be responsible for all costs associated with such costs.</p>
<p><b>Issue No. 4 – Third-party Standards</b>  <i>Expectation: The agreement will require the franchisee to meet all legal or third-party water and wastewater quality standards, and to bear the associated costs.</i></p>	<p>The quality of water supplied should meet all standards of practice. The franchisee should be responsible for meeting the standards.</p>
<p><b>Issue No. 5 – Legal Responsibilities</b>  <i>Expectation: The agreement will define clearly all legal responsibilities between the two parties for matters such as: access to properties, trade waste bylaws, issues concerning the Public Works Act 1981, and other responsibilities imposed by the Local Government Act.</i></p>	<p>The local authority will have a range of legal responsibilities to carry out its activities. It should draw up a suitable franchise agreement covering the required activities.</p>
<p><b>Issue No. 6 – Maintenance Performance</b>  <i>Expectation: The agreement will set up specific performance measures for maintenance and renewal of, and additions to, the water and wastewater networks.</i></p>	<p>The maintenance, renewal and augmentation of the infrastructure is a key success or failure of a franchise agreement. Ongoing monitoring by ratepayers, and significant attention should be given as a component of any franchise agreement.</p>
<p><b>Issue No. 7 – Extreme Events</b>  <i>Expectation: The agreement will require the franchisee to prepare a set of procedures to deal with a range of extreme events/Acts of God. The local authority should itself have a set of such procedures.</i></p>	<p>The responsibilities of both parties and the local authority in the anticipation of extreme events. Planning for contingencies (insolvency, etc) should form a part of the franchise agreement.</p>
<p><b>Issue No. 8 – Customer Service Standards and Customer Charter</b>  <i>Expectation: The agreement will require the franchisee to:</i>  ↓#supply the services to a set of minimum service standards; and (if warranted)  ↓#establish a customer charter, after consultation with its customers, setting out detailed service standards.</p>	<p>The quality of customer service from the franchisee is a key requirement of the franchise agreement. Either specific standards for a customer charter, should be included in the franchise agreement should have regard to the standards in the franchise guidelines.</p>
<p><b>Issue No. 9 – Price Regulation</b>  <i>Expectation: The agreement will include a mechanism for regulating the prices charged to customers.</i></p>	<p>Given the monopolistic nature of a water and wastewater franchise, it is essential to prevent unreasonable price increases. The franchisee should balance the potential revenue stream, the cost of investment in the assets. This is a complex issue and the local authority should assure itself that the franchise agreement meets the required objectives and outcomes.</p>

<p><b>Issue No. 10 – Price Differentiation</b>  <i>Expectation: The agreement will include provisions to encourage the franchisee to provide a system of price differentiation for different classes of consumer.</i></p>	<p>The agreement conditions should be designed so that the agreement should include incentives for the franchisee to influence demand characteristics during peak periods.</p>
<p><b>Issue No. 11 – Customer Bonds</b>  <i>Expectation: The agreement will require the franchisee to establish rules for customer bonds.</i></p>	<p>The contractual relationship between the supplier and the franchisee with the emphasis of responsibility on the franchisee should be on a timely basis and with interest. This is an issue for the local authority.</p>
<p><b>Issue No. 12 – Accuracy of Water Meters</b>  <i>Expectation: The agreement will provide for standards for monitoring the accuracy of water meters.</i></p>	<p>It is important that the public and suppliers are protected from result in inaccurate charging. This should be included in the customer charter.</p>
<p><b>Issue No. 13 – Poor Performance and Non-performance by the Franchisee</b>  <i>Expectation: The agreement will include:</i>  ↓ # <i>definitions of poor performance and non-performance by the franchisee; and</i>  ↓ # <i>mechanisms to deal with those circumstances.</i></p>	<p>The local authority needs to give the public legal certainty to meet the terms and conditions of the agreement. The franchisee knows what it is expected to do under the franchise agreement, and minimise the potential for unsatisfactory performance.</p>
<p><b><i>Managing and Monitoring the Franchise</i></b></p>	
<p><b><i>Context</i></b></p>	
<p><b>Issue No. 1 – Resources</b>  <i>Expectation: The local authority will have allocated suitable resources and established the necessary systems to manage and monitor the franchisee's performance under the franchise agreement and, in particular, the franchisee's adherence to the customer service provisions of the customer charter.</i></p>	<p>The local authority should have resources available to manage, monitor and audit the activities of the franchisee and the authority in order to provide assurance that all franchisees are complying with the agreement.</p>
<p><b>Issue No. 2 – Information</b>  <i>Expectation: The local authority will have access to sufficient information from the franchisee to allow it to assess, validate and audit the franchisee's performance.</i></p>	<p>The local authority should have access to information from all franchisees of the network to ensure protection of the public and customer service. Access to information should be provided to the franchisee and, in due course, to have the work audited by the incumbent or at agreement renewal time.</p>

<p><b>Issue No. 3 – Monitoring Maintenance</b>  <i>Expectation: The local authority will put in place procedures and performance specifications to enable it to monitor maintenance and renewal of, and additions to, the assets during the franchise.</i></p>	<p>It is central to success of the franchise that throughout the term of the agreement. The local authority should ensure that the community could be at risk if the assets are not maintained. The local authority should establish regular monitoring procedures to ensure that the condition of the assets is maintained from the start to the end of the franchise.</p>
<p><b>Issue No. 4 – Monitoring Customer Service</b>  <i>Expectation: The local authority will put in place procedures to enable it to monitor customer service and quality assurance performance during the franchise.</i></p>	<p>The assessment of the quality of customer service and the level of service provided is being accurately monitored by the local authority. This should be linked to the customer service standards set out in the franchise agreement.</p>
<p><b>Issue No. 5 – Poor Performance and Non-performance Procedures</b>  <i>Expectation: The local authority will create procedures for dealing with poor performance or non-performance by the franchisee.</i></p>	<p>In the event of non-performance by the franchisee, the local authority should ensure that the interests of ratepayers are protected. The local authority should ensure that the franchisee has procedures in place for a minimum to meet minor quality standards through to total non-performance, which is directly linked to the customer through self-regulation.</p>
<p><b>Issue No. 6 – Asset Condition on Return</b>  <i>Expectation: The local authority will create procedures for assessing the required condition of the assets to be returned to its control at the end of the franchise.</i></p>	<p>The local authority should ensure that, at the end of the franchise, the assets are transferred back to the authority in a suitable condition. The local authority should have suitable resources to ensure that the required condition is met.</p>
<p><b>Issue No. 7 – Liaison with the Franchisee</b>  <i>Expectation: The local authority will put in place procedures for regular communication with the franchisee.</i></p>	<p>Effective communications foster a close relationship between the local authority and the franchisee. Regular communication should be appropriately managed by the local authority in the administration of the franchise agreement.</p>