

Report to:	Council – Public Excluded	
Date:	31 May 2023	
Subject:	Proposed Extension of Water Services Contract	
Prepared by:	D Clibbery – Senior Manager Operations	
Input sought from:		
Authorised by:	W Doughty – Chief Executive Officer	

1. SUMMARY

It is proposed that the term of Council's existing contract with Innovative Waste Kaikōura for operation and maintenance of water services, which expires on 30 June 2023 is extended for up to 4 years.

2. RECOMMENDATION

It is recommended that:

- a) The term of KDC Contract 166 – Operation and Maintenance of Water Services – is extended by 2 years to expire on 30 June 2025, with a potential further extension of 2 years to 30 June 2027 subject to the agreement of both KDC and IWK at that time
- b) The Council delegates the Chief Executive Officer to determine the release of this public excluded report.

3. BACKGROUND

KDC Contract 166, for Operation and Maintenance of Council's water services, expires on 30 June 2023, and a decision needs to be made in respect of arrangements for delivery of these services after that date.

Payment by Council to IWK under this contract currently total around \$700,000 per year. Of this around \$400,000 is for fixed monthly lump sums and the remainder is for variable costs. In addition, IWK undertakes a number of project type works outside of the contract, the extent of which is highly variable.

The current contract was put in place in July 2021 but was backdated to be effective from 1 July 2020. The contract was negotiated with IWK to address a lack of formal contractual arrangements between Council and IWK that had existed for some years.

Contract 166 was based on a contract document which had been under development since early 2019. That document had originally been presented to IWK in that year, prior to the employment of any KDC staff currently involved in the management of these activities.

Delay to the negotiation and implementation of the contract subsequently occurred through further consideration of delivery options for these and other services during the Financial and Corporate Sustainability (FCS) programme for KDC that was initiated by central government following the Kaikōura earthquake.

This consideration included preparation of reports in 2019 by Morrison Low and Tonkin and Taylor consultants which whilst primarily focussed on the form and functioning of IWK, also addressed many of the matters required to be addressed in reports on delivery options for services required by Section 17A of the Local Government Act 2002.

Whilst these reports raised a number of concerns regarding IWK and questioned the value of the CCO, Council was at that time reluctant to discontinue it, and this, together with challenges associated with Covid resulted in an eventual decision to proceed with the awarding of a new contract for 3 waters to IWK on a negotiated basis.

This was viewed as a pragmatic approach to the issues that existed at that time, but it was also envisaged that at some time in the future an open tender of these services would be conducted.

It was however also recognised that because of the small and relatively isolated nature of Kaikōura there would probably be limited competition for such a tender, and that there was a strong likelihood that IWK would win a further contract, as occurred when Council's solid waste services were openly tendered. Despite this there was still considered to be potential benefit in conducting such an open tender, if only to conclusively confirm that best value was being achieved.

The performance of IWK in this contract has generally been satisfactory. The IWK waters team very capable and experienced staff who have deep knowledge and understanding of Council's 3 waters services, the value of which should not be underestimated.

A persistent area of weakness has however been in respect of reporting against key performance indicators, which is believed attributable to a combination of the IWK team being very practical hands-on operators who focus on getting the job done rather than recording details, and persistent problems with IT systems, in particular KDC's ADAPT asset management system and its interface with other council systems.

Some good progress has however been recently made in respect of reporting, albeit through use of an simple spreadsheet recording system instead of ADAPT and it is currently believed that this may finally be able to provide a solution to this issue. The required performance indicator reporting is also clearly identified as needing improvement in the IWK Statement of Intent for the year ahead.

4. FUTURE OPTIONS

Shortly after Contract 166 commenced a further factor influencing future awarding of Council's water services contract emerged, in the form of central government's announcements on the proposed reform of Three Waters service delivery. This influence further strengthened with the governments decision in October 2021 to proceed with a new 4 Entity delivery model, with these entities planned to go live on 1 July 2024.

It appeared that the lack of clarity that existed at that time regarding how contractual arrangements would be affected by the transition to this new model, when combined with the small scale and isolated nature of KDC's water activities, would result in even less interest in an open tender of our water services operations and maintenance.

Whilst there are elements of the service provided by IWK under contract 166 where improvement is desirable (particularly in respect of reporting) and which could possibly be better achieved under different management, there are also aspects of the service that are being delivered well at what are believed to be very competitive prices, and there are risks associated with an open tender that include:

- Potential for IWK to significantly increase their prices if they expected (as is suspected) that the level of competition will be very low.
- Creating further uncertainty for relevant IWK staff in respect of their employment.

- Potential loss of staff with key local knowledge if uncomfortable with the management regime of a new contractor (noting that the expectation would be that a new incoming contractor would seek to employ the existing IWK staff).

For these reasons a tender of KDC's water services is not recommended at present and it is instead suggested that the most practical course would be an extension of Contract 166 beyond the current 30 June 2023 expiry date.

As the logistical challenges of the reforms became increasingly apparent it also became clear that such contract extensions would need to extend beyond the commencement date for the new entity, with those extended contracts being novated (transferred from KDC to the new entity). The Three Waters National Transition Unit had however also indicated their expectation that the extent to which the term of such contracts is increased should be limited, with expiry dates preferably 2 or 3 years after the establishment date of the Entity.

On this basis it had until recently been envisaged that KDC Contract 166 might be extended until 30 June 2026.

The announced changes to the proposed reforms with the greater number of new entities have however extended 'go live' dates for these new entities to not later than 1 July 2026, and as such it might now be appropriate to extend Contract 166 for a further year, with an expiry date of 30 June 2027.

It is however recognised that this would be a substantial extension, and that the practice of extending existing contracts without an opportunity for challenge may stifle opportunities for business development and innovation.

There is also recognition that much uncertainty continues to remain regarding the water reform, and that it may not proceed in the form that is currently proposed, with the results of the forthcoming general election likely to affect this.

If it became clear that major national reform of 3 waters was not going to proceed it would then probably be appropriate for KDC to again conduct its own review of the delivery options for these services in the format specified under section 17A of the LGA, with a possible conclusion of this being that an open tender of the services should be conducted.

In that circumstance it would be desirable that such a tender was conducted fairly quickly. To enable such an eventuality to be accommodated it would be preferable that the term of Contract 166 expired well before 30 June 2027, and a potential solution to that would be that the current extension of Contract 166 offered to IWK was for an initial 2 year term with a further 2 years subject to the agreement of both parties.

An extension of this form would be likely to provide a period of at least 12 months in which an internal review of service delivery and a subsequent procurement process could be undertaken, and hence such a 2+2 extension of the contract is recommended.

5. IMPLICATIONS OF EXTENSION

It is envisaged that if Contract 166 was to be extended, this would be done whilst largely retaining the contract in its current form. The contract provisions are generally considered to be adequate, and it is believed that where unsatisfactory performance has occurred that this has generally been attributable to the provisions of the contract not being followed rather than those provisions being inadequate.

It is however intended that some minor changes are made to strengthen contract provisions, particularly in respect of the reporting, making a requirement for response dates and times to accompany invoices if those invoices are to be paid.

Contract prices are subject to defined cost escalation factors linked to inflation indices and as such there should generally not be a need for any other special adjustments to be made.

One exception to this is however in respect of dayworks rates, which are not inflation linked and the rates are currently the same as those set in 2020, and IWK have recently requested that those rates be increased, which is not considered an unreasonable request.

6. FINANCIAL IMPLICATIONS AND RISKS

The proposed extension of the existing contracts avoids the immediate uncertainties and risks associated with an open tender that were outlined on the second page of this report. It is however recognised that these risks could arise again in the future if an open tender was conducted, and that these risks might be even larger in the future if the tender was to be undertaken closer to a proposed reform implementation date.

It also continues to be suspected that IWK's financial position may worsen once the refuse transfer station commences operation and opportunities for cross-subsidy of activities from refuse revenues are reduced, which might in turn cause IWK to seek to increase the price of their services in the 3 waters area.

7. RELEVANT LEGISLATION & DELEGATED AUTHORITY

The legislation most relevant to the matters covered in this report is section 17A of the Local Government Act 2002 – Delivery of Services, in particular that under s17A(1) & (2):

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

(2) Subject to subsection (3), a review under subsection (1) must be undertaken—

(a) in conjunction with consideration of any significant change to relevant service levels; and

(b) within 2 years before the expiry of any contract or other binding agreement relating to the delivery of that infrastructure, service, or regulatory function; and

(c) at such other times as the local authority considers desirable, but not later than 6 years following the last review under subsection (1).

Because of the continuing indications of major national reform of 3 waters service delivery it is however considered that undertaking a s17A review of these services at KDC at this time cannot be justified on the basis of s17A (3)(B)

.....that.... the local authority is satisfied that the potential benefits of undertaking a review in relation to that infrastructure, service, or regulatory function do not justify the costs of undertaking the review.

8. COMMUNITY OUTCOMES SUPPORTED



Community

We communicate, engage and inform our community



Environment

We value and protect our environment



Services

Our services and infrastructure are cost effective, efficient and fit-for-purpose



Future

We work with our community and our partners to create a better place for future generations