Approach to price-quality regulation for Watercare

A report for Water NZ, December 2025

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Executive summary

This short report comments on the Commerce Commission's (the Commission) price-quality path for Watercare approach paper. It builds on our recent short report on information disclosure (ID) for water service providers.

In this report we comment briefly on the main substantive matters in the approach paper, highlight the missing components and comment in greater depth on the timelines. We think:

- The high-level concepts set out by the Commission make sense. The building blocks model (BBM) and principle of real financial capital maintenance (real FCM) are tried and tested and should not be controversial.
- The paper omits key BBM components, creating uncertainty over whether the proposals enable revenue adequacy or support financial sustainability.
- The absence of clear rules or 'input methodologies' (IMs) precludes certainty and inhibits application of price-quality (PQ) regulation. Early clarity on rules is essential.
- Proposed timeframes appear infeasible, steps to 'buy' time are needed:
    - early guidance, deferring discretionary elements and tightening Commission timeframes could compress timeframes by ~12 months, but even so
    - proposed timeframes would remain exceedingly tight and transition plan should be considered to reduce pressure on Watercare, its stakeholder and the Commission.[1]
- The Commission will need to show genuine pragmatism and work closely with Watercare, as de facto test case for PQ regulation in the water sector (but acknowledging this is specific to Watercare and PQ regulation may apply differently, it at all, to other water entities).

1.1 BBM and real FCM

The BBM and principle of real FCM has been applied to several New Zealand utility sectors and in peer jurisdictions overseas. This regime is generally recognised as being effective in promoting the purpose statement, noting this is virtually identical for electricity, gas, fibre and water.

Provided rules are clear, this package offers a combination of certainty and predictability that investors seek, reducing the cost of capital, and supports efficient investment in networks and business capability.

Whether real FCM holds true depends on the Commission's approach to setting the initial RAB, asset valuation and the weighted average cost of capital (WACC). The latter is an obvious omission from the approach paper.

1.2 Clear rules needed for PQ to operate effectively

The Commission has discretion over when to set IMs, but statutory deadlines apply to PQ regulation for Watercare.

This creates a catch-22 like conundrum as the Commission does not have to establish IMs, but the regulation does not work without clear rules.

Those are important for regulatory predictability and investor confidence but also at a practical level:

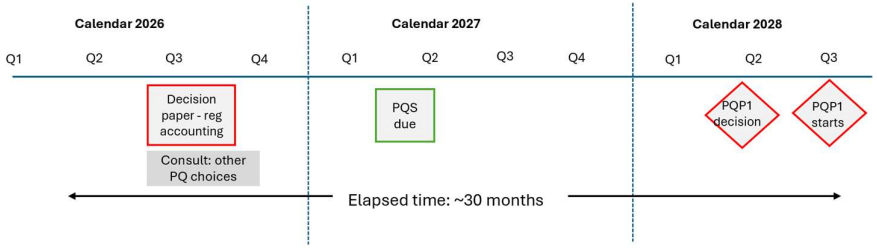
[1] For example, as applied to Transpower in its first regulatory period.

- specifying fundamental aspects of regulatory accounts and revenue
- how PQ regulation will work in practice, including the scope and content of PQ submissions (PQS), terms of reference for independent verification (IV), price-quality trade-offs (essential for consumer engagement).

It is unlikely the Commission could (or should seek to) establish a full set of IMs in time to support Watercare's first PQS, proposed for mid-2027. However, there are relatively low-effort and timely steps it can take to give Watercare *much* of what it needs to prepare its first PQ period (PQP) and enter its first PQP.

1.3 Timeline feasibility

At face value, the 30 months between now and start of Watercare's first PCP may appear sufficient.



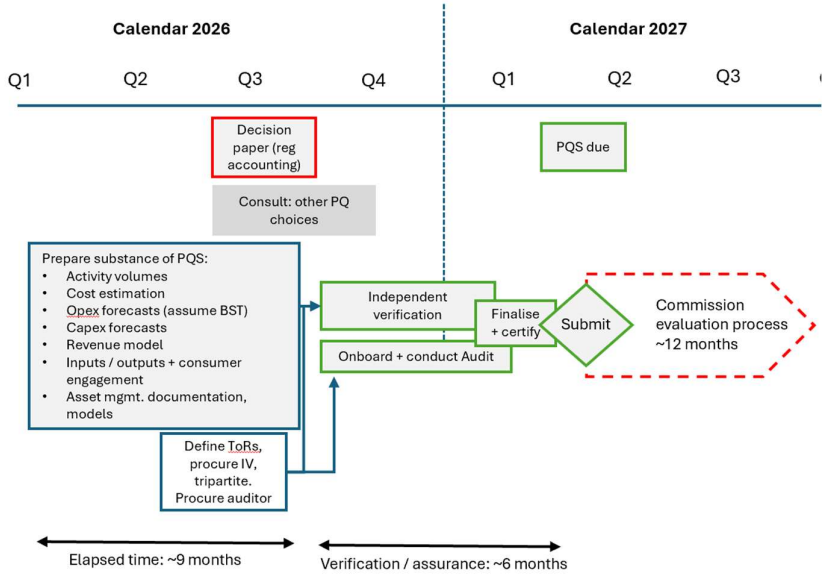
However, while the approach paper touches on enabling steps and sets out very high-level milestones it does not engage on:

– the basic rules Watercare must follow and comply with in preparing its PQS or when these will be set

– the logical (and necessary) sequence of events in preparing for and then producing an independently verified, audited and Director-certified PQS as envisaged in the approach paper

– overall, the scale of the task involved for Watercare to prepare its first PQS.

Our breakdown of the Commission timeline suggests Watercare will have, at most, 9 months – more likely 6 months - to prepare for and produce its PQS, including customer engagement, before it enters IV and audit processes.



For context, in our experience a regulated entity[2] would typically start preparing a PQS 2 to 3 years prior to submission. This assumes established and understood IMs, embedded capability

[2] We infer that Watercare will be subject to individual price-path regulation, akin to that applied to Transpower and Chorus.

and experience, PQ optimised business processes / practices, asset management documentations that are implemented in operational and strategic asset management, demand / activity and expenditure forecasting tools as well as a mature stakeholder group to gain meaningful insights from external engagement.

The process can be compressed to a degree but there is a logical sequence and development process. Curtailing that is possible and may be necessary, but would:

- affect the quality / robustness of the PQS, reducing the benefit of an otherwise value adding process
- force the entity to prioritise hard compliance obligations over the genuine improvement and maturity gains a well-run individual price path (IPP) process drives.

We acknowledge Watercare has been on a learning curve under Charter regulation, however, strongly suggest being mindful of the implications as the IPP process is demanding for staff of the regulated entity and the regulators evaluation team. The timeframes and requirements stated or implied in the approach paper significantly increase demands on staff of the respective organisations. This puts at risk the wellbeing of staff and an important but formative relationship between the Commission and Watercare.

Such risk is elevated further as Watercare (likely resourcing these activities with similar/same staff) will also be executing on Charter derived plans and implementing ID regulation concurrently.

2 Introduction

2.1 This report

Water NZ asked Concept Consulting Group (Concept) to prepare a short report, including commenting on:

1. The general merit of the proposed approach for Watercare's price-quality path
2. Departures from the approach taken for other sectors, the extent to which this is justified and potential risks / issues
3. Implementation and practical lessons from other sectors to avoid unnecessary cost / complexity
4. Extension beyond Watercare.

We address these points in our report. We comment briefly on the substantive proposals, recognising their preliminary / high-level nature. We place additional focus on the proposed approach in the available timeframes and how this might be made feasible.

2.2 Assumptions

The future application of PQ regulation beyond Watercare remains subject to future policy decision.

However, our working assumption is that PQ regulation will be applied to many, possibly all, water entities with some tailoring to reflect the differing scale / circumstances of water entities. For example:

- the largest entities could be subject to IPP type regulation
- smaller entities will be subject to default price-quality path (DPP) like regulation (or ID-only regulation).

Financial sustainability is non-discretionary. The primary enabler for this is setting revenues at a level that allows Watercare to finance its operations and debt *and* to accumulate reserves. The latter is necessary for long-term financial sustainability.

2.3 The authors

Concept's team contains some of New Zealand's foremost experts in the economic regulation of utilities. This expertise spans the full regulatory lifecycle – from policy and rule design, first application, operation and review.

The authors of this report are Florian Steinebach and Jeremy Cain; their experience includes:

- working as economic regulators and within regulated entities in New Zealand and the UK.
- preparing disclosures and other regulatory deliverables including PQ proposals, compliance statements.
- leading asset management capability, efficiency, forecasting and cost estimation initiatives (multi-sector).
- managing regulator relationships and managing or advising on compliance investigations.
- in senior management roles within regulated entities responsible for regulatory deliverables and their assurance (external audit, independent verification, internal assurance, Director certification).

This experience is across the electricity, gas, telecommunications and water sectors.

3 Concepts and initial proposals

3.1 Concepts

In general, the proposed concepts of BBM and real FCM make sense and are well understood from other utility sectors (with the exception of water sector specificities).

That includes ~15 years of learning, development and refinement in New Zealand - with hundreds of consultations, several major reviews and multiple reset events across the gas, electricity and fibre sectors.

We note this iterative process allowed regulated entities, stakeholders and the Commission to build institutional knowledge over time.

It can reasonably be assumed that Watercare, other water entities and sector stakeholders do not have this degree of experience or institutional knowledge yet.

3.1.1 Perfection the enemy of good

Extending PQ regulation to Watercare is likely to bring significant benefits. However, we consider it likely:

- those benefits will be delayed or diluted if the initial implementation is rushed
- effort is better placed on foundational elements than implementing the full suite of features, some of which are "nice to have".

Where New Zealand electricity, gas and fibre entities had experience of economic regulation prior to implementation of PQ regulation, Watercare has only recently moved under Charter regulation that is conceptually similar but lacking detail and depth. Other water entities generally do not have much relevant experience.

In any scenario, there will be a steep learning curve for Watercare and other water entities and stakeholders, but if it is unrealistic then ultimately it is consumers who will suffer.

Proportionality and pragmatism

There are several measures the Commission could adopt to ease the path into PQ regulation for Watercare. Some of these measures, listed below, could be adopted as a 'transition package':

1. omit mandatory IV for PQP1, as done for Transpower and Chorus (alternatively, scale back scope for IV materially)
2. endorse scaled-back engagement for PQP1
3. scale back audit requirements for PQP1
4. decide that IMs and price path mechanisms from other sectors can be adopted for PQP1 while water-specific rules are developed
5. minimise divergence GAAP
6. include a transition year(s), for example by rolling-over key PQ path elements from 2027 (the last year under the Charter) to 2028 (first year under PQ regulation), and shorter first regulatory period
7. commit to pragmatic / lenient evaluation of first PQS, recognising it is a first step only.

These measures are straight forward to implement and would reduce the burden on Watercare, its stakeholder and the Commission. They could be adopted and communicated to Watercare early in 2026, providing clarity, confidence and a degree of certainty. We elaborate on these measures in Appendix [C].

3.2 Initial RAB and additions

The basic position outlined in the approach paper is reasonable, that is – the initial RAB value should be current book value less revaluations, the value of vested assets and IFF project assets.

3.2.1 Actual information preferable to 'deeming'

The approach paper then notes there may be difficulty determining the historical cost of Watercare's existing and vested assets, and the possibility the result would result in insufficient revenue.

However, we are doubtful that 'deeming' is necessary or optimal. We:

- are unsure how difficult it would actually be to determine the starting RAB using actual historical cost but consider doing so to be preferable if possible
- agree it is possible the actual cost-based RAB will not support revenue adequacy but would want to see this tested rather than remain an assumption.

At a practical level, it is not straight forward to deem (i.e. goal-seek) the initial RAB value. This may be straight forward if optimising one parameter against a single criterion, but less so when optimising for multiple criteria:

1. high enough to cover Watercare's cash flow needs
2. consistent with maintaining an investment grade rating, but
3. not so high that it gives rise to excessive profits.

… utilising multiple as-yet-unknown parameters, such as:

- cost of capital
- whether the RAB is indexed
- cost allocation
- asset lives and depreciation
- revenue smoothing

3.2.2 A slippery slope

Deeming, in preference to actual information, risks abstracting away from both reality and established and tested, including by the High Court, practice and rules. This could put the credibility of the new regime at risk from the outset.

We suggest it would preferable to:

1. determine each parameter on a principled basis and using the best information available
2. assess whether a revenue adequacy or financial sustainability problem exists[3]

then, if so:

3. identify the direct (e.g. revenue) and indirect (e.g. incentives) effects of adjusting different parameters
4. adjust the parameter(s) that best achieve the policy objective by the amount(s) required

Ideally, this would be done transparently and ahead of a PQ setting process, not only because the initial RAB (and in subsequent periods the opening RAB) is a key PQS input, but also because deciding on the initial RAB is likely to distort the PQ setting process significantly due to its significance, away from typical focus areas such as prudent and efficient cost forecasts and resulting consumer outcomes.

[3] The BBM, applied even-handedly, should preclude the possibility of excessive profits.

Such an approach would mitigate the risk the new regulatory regime is not perceived as principled, and of potential legal or other challenge.[4]

3.2.3 RAB additions

The approach proposed appears consistent with that currently applied to other regulated entities, albeit without specificity.

While not stated, we assume (based on the principle of real-FCM) that Watercare will be 'kept whole' where assets are stranded, written off or otherwise required to be removed from the RAB.

3.3 Revenue adequacy and financial sustainability

The approach paper notes the requirement to ensure revenue adequacy and financial sustainability. It does not discuss what each means or how these requirements might be met through the design and application of the PQ regime.

While no explicit requirement exists for other entities subject to PQ regulation, revenue adequacy is at least implicit. It can (and largely is) taken as given that a regulated entity can remain financially sustainable because price paths reflect:

- a return on capital at or above the weighted average cost of capital, enabling efficient risk and capital management actions
- a return of capital, according to a predictable trajectory enabling efficient risk and capital management
- recovery of all other efficient costs (such as operate and maintenance costs) necessary to sustain a business and to meet customer expectations.

Assuming the same approach is adopted for Watercare, it is reasonable to expect it will have adequate revenues and be financially sustainable. Following Commission precedent would allow Watercare to maintain or improve its financial sustainability, to:

- Build financial reserves / equity necessary to 'ride through' shocks and invest confidently in human capability, information systems, business process improvement and innovation
- Maintain debt ratios / metrics needed to secure funding as investment increases (and debt increases)
- Adopt and follow a prudent capital management policy including, potentially, return of any surplus funds through pricing (as some electricity distributors do today)

It is worth noting that the real-FCM and BBM does not guarantee financial sustainability. For example, regulation cannot protect a business from market / technological change or from its own decisions.

3.4 Weighted average cost of capital

There is no discussion on WACC beyond noting that Watercare is prohibited from paying dividends and is income tax exempt.

Ideally, WACC would be addressed as a priority. Leaving these and other important decisions impacting Watercare's financial viability to the last minute will distract from what a PQP process is intended to achieve, i.e. engagement on forecast costs, revenue and customer outcomes.

[4] Noting deferral of IMs removes merits review, an important recourse and means of holding the Commission to account.

As noted above, we assume the Commission will adopt the same WACC methodology applied to other regulated entities, at least until it goes through the process of setting water-specific IMs.

3.5 Revenue smoothing

Revenue smoothing can be a valuable tool for managing revenue (and price) volatility, but it has risks and downsides, and caution should be exercised over whether and how smoothing is applied.

For example, experience – including the 2025 electricity network price resets - has shown that smoothing can contribute to price shocks (rather than mitigating them). For example, that is because smoothing allows large wash-up balances to accrue within a period, triggering unpalatable step changes at resets. Smoothing can also disconnect the timing of revenue from when funding is needed, impacting on a firm's ability to raise debt at efficient cost.

3.6 RAB indexation

The approach paper implies the RAB could be indexed to CPI with RAB revaluations deducted from revenue. The effect of indexation, which applies to other New Zealand regulated utilities, is to defer cashflows. The cashflow effect is material, potentially very material.

Whether or not the RAB is indexed is an important question that should be given careful consideration. We note, for example, that Transpower's RAB was not indexed initially due (at least in part) to the need to finance Transpower's then major investment programme.

We also note the significant revenue 'shock' and compliance cost of introducing indexation later, as recently occurred for Transpower.

If a similar approach (deferring indexation) is adopted, clarity over future introduction should be given at the outset. This will allow Watercare to 'design-in' future indexation when establishing financial systems for regulatory accounts and for treasury management.

3.7 Accounting principles and GAAP alignment

We agree that it is beneficial to maximise alignment between the GAAP and regulatory accounts, specifically for the RAB.

While full alignment between regulatory accounts and GAAP is not achievable, departures from GAAP should be minimised. This serves to:

- reduce compliance and assurance costs
- improve management and Directors' comprehension of regulatory accounts[5]
- reduce risk of error / unintentional non-compliance.

In our experience, the more departures from GAAP, the harder it is to embed regulatory accounting into business management and to build necessary understanding with Directors, inhibiting their ability to exercise their duties.

While asset valuation and revaluation (indexation) mean total alignment is unlikely, discretionary departures should be minimised.

For example, the rule – applicable to some but not all currently regulated entities – of not allowing depreciation in the year an asset is commissioned has no obvious benefit, but drives complexity, compliance cost and risk.

[5] As noted by Alpine Energy Chair, Melissa Clarke-Reynolds in here recent article for the Institute of Directors https://www.iod.org.nz/news/articles/inside-a-16-9-million-regulatory-breach-what-the-chair-did-next

3.8 Forecasting uncertainty

The approach paper references reopeners but is otherwise silent on the very important topic of dealing with forecasting uncertainty

Uncertainty is likely to be one of the key issues for Watercare and the Commission to deal with for PQP1, and subsequent PQPs.

Uncertainty mechanisms are important for regulated suppliers at the expenditure planning stage, affect forecast practices and risk. There should, we suggest, be:

- A demand wash-up,
- Individual capex proposal (ICP) mechanism, both akin to Chorus

Depending on the approach taken to managing real-FCM, additional measures may be required. For example, reopener provisions akin to those in place for electricity distributors.

We note, however, the risk of a proliferation of reopener applications across water and electricity sectors (along with ICPs and Transpower major capex projects).

3.9 Other PQ mechanisms

Chapter 5 touches (very) briefly on matters crucial to Watercare as it prepares its first PQS.

It is essentially a list of not-yet-addressed issues the Commission expects to consult on in June-September 2026 and decide on in March-June 2028. Earlier clarity (than June-September 2026) is desirable.

4 Key issues

4.1 Rule ambiguity / power imbalance

Given tight timelines it is understandable why the Commission wants to delay the IM setting process until after the PQP decision and instead want to rely on interim rules.

Further, the approach paper indicates that interim rules will not be settled until the final PQP decision in March-June 2028.

While understandable, this presents three important issues:

1. an extended period of regulatory uncertainty
2. a practical problem of how to go about preparing a PQS, engaging customers, performing IV and audit and certification
3. a power imbalance in the Commission favour, with limited recourse for Watercare (and therefore limited accountability for the Commission).

These are fundamental, both to the purpose and integrity of the regime, and to its practical application by Watercare and the Commission. As noted, in section [3.1], there are measures available to the Commission to address each.

4.2 Early clarity on rules is essential

The approach paper tackles these important issues at a conceptual level only and omits discussion of certain vital parameters entirely. As a result, it is unclear:

- what the Commission expects / requires Watercare to do / include in its first PQS
- how it would calculate – or even estimate – allowable revenues under the price path.
- how Watercare could develop an informed PQS, understanding broadly what revenue would be, to:
    - scope, terms of reference and tripartite rules for IV, which would need to commence in September 2026 at latest
    - certify revenue adequacy / sustainability
    - engage stakeholders (e.g. on price/quality trade-offs)

Clarity is required on WACC, and the other variables listed above, so Watercare can at least estimate allowable revenues. It was not clear to us from the approach paper when this clarity would be provided.

Uncertainty on these fundamental matters *will* adversely impact preparation, evaluation and satisfaction with the first Watercare PQS.

4.3 Managing the Watercare transition into PQ

In our recent report on ID for the water sector we emphasised the importance of the transition into the new disclosure regime. The essence of those comments applies to PQ for Watercare, and in due course other entities.

While little detail is available on exactly what will be required of Watercare, we expect (based on experience with the two other IPP regulated entities in New Zealand, Transpower and Chorus) requirements to be extensive.

While entities adapt / optimise for these requirements over time, they are particularly onerous / challenging when first introduced and applied. This necessitates careful and realistic transition planning by the regulated entity and the Commission.

The key risk is *diverting from, rather than reinforcing,* the quest to lift capability, performance and transparency. That is, entities are

forced into a compliance mindset and lose sight of the real prize. This is, in our experience, a very real risk.

We note that the transition into ID and PQ regulation differed for each of Transpower, Chorus and other electricity and gas networks according to their circumstances. For example:

- Transpower: transitional first PQP while the Capex IM was developed[6] for PQP2. No requirement for IV until PQP3. ID introduced several years after entry into PQ regulation.
- Chorus: all IMs available prior to first PQS, no requirement for IV for PQP1. ID introduced from start of PQP1.

This tailoring of the transition is important. The layering of regulatory outputs (ID/PQ) has a significant bearing on an entity's approach to and ability to build business capability in areas that are central to the long-term benefits of consumers.

For example, as we understand it, Watercare will need to:

- meet ambitious deliverables under the Charter
- meet new ID requirements, that are more extensive in nature than those applied to other sectors
- prepare its first PQS – without clear rules

at the same time, and while delivering:

- significant business capability / change
- its core business / operations.

In this context, something has to give. In our experience, businesses go to great lengths to meet hard compliance requirements. This usually comes at the expense of business capability development (human, process, systems) and, often, staff welfare.

4.4 Preparing a PQ submission

The uninitiated are unlikely to appreciate quite what is involved in preparing a PQS.

This is in part because requirements have not been set and in part because what is involved in meeting the requirements only becomes clear through the doing.

4.4.1 PQS a (very) big ask

An entity's first PQS is challenging and a steep learning curve. It requires creation of new information, creating new business processes, acceptance of materially greater transparency and public / regulatory scrutiny.

It requires Directors to certify historical and forecast information (quantitative and qualitative) that is extensive in scope and depth and significantly beyond what is required for statutory accounts or listed entity disclosures.

It requires stakeholders to be educated on business and sector specificities and most importantly regulatory implications to gain value from usually resource intense and costly consultation processes. This should not be under-estimated.

Appendix A contains links typical requirements and processes for a PCS for an IPP. It links to recent comparable processes for Transpower and Chorus.

[6] The Capex IM specifies what is required to be included in a capex proposal, complemented by an information notice covering opex and other information requirements.

4.4.2 Business capability requirements

Each entity will need to build business capability. This is a combination of human resources, operational and strategic asset management capability, information systems, business processes relating to the disclosures (including governance and assurance).

It entails building a clear understanding of rules and requirements, then working out how to meet these with existing information or, often, to create new information.

A PQS is less a regulatory output than a strategic business plan – but one that is subject to public and regulatory scrutiny. This means staff from across the entity need to be 'educated' and upskilled and in many cases be required to significantly change existing practices and processes (it cannot be assumed businesses follow all textbook management approaches already, even if that were in their best interest).

As with meeting ID requirements, meeting PQS requirements will 'touch' most business functions. In our experience:

- A central programme management function is needed to coordinate, guide business teams, advise management and Directors, manage the IV process, Commission interfaces and stakeholder consultation processes. It needs to have a certain level of technical expertise (economic regulation) but will need to draw on internal expertise and external advice.

  However, the quality of deliverables and 'stickiness' of business capability / change are improved where accountability is functionally allocated. For example, accountability for quality standards should sit with the relevant operational team, rather than a corporate regulatory function.

- Coordination, change management is important; both for preparation and assurance of regulatory deliverables – but, also for the business capability uplift and changes required to embed new capabilities in processes, systems and decision making.

- While well-structured governance is essential from the outset, the nature of the task will evolve as each entity progresses from establishment and implementation to ongoing operation. The initial stages are particularly challenging (and important) as each entity:
  - gets to grips with the requirements (not to be underestimated), assigns accountability and establishes compliance management capability.
  - 'educates' different business teams, executives and Directors / equivalent on: what the regulation is, what it seeks to achieve, how it works in practice, accountabilities, what it means for each person, how they meet their obligations.
  - identifies FTE gaps and recruits and upskills new staff.
  - develop policies, strategies and plans – all of which require oversight (and often will require CEO or Board endorsement, not least due to the financial implications, e.g. for asset management).
  - develops requisite technical competencies, identifies what information is required, works out how to source this information – often using interim or MVP (minimum viable product) sources and methods.
  - prepares regulatory deliverables, applies internal assurance, external assurance including upskilling auditors, obtains Director certification, publishes / submits.

- Ideally the entity, in meeting 'first time' deliverables, will work out what business change is required (business

processes, information systems), plans to execute, allocates and recruits resources, executes, ensures change is embedded. The scale of change and time taken differs according to entity (e.g. according to information systems functionality) and the nature of change (e.g. asset management changes may be pervasive, requiring behavioural, competency, process, system changes for different business units and 3rd parties).

The list above is illustrative, not exhaustive.

5 PQ for the wider water sector

At this point, only Watercare is certain to be subject to PQ regulation, so the approach paper naturally focuses on Watercare.

However, the approach paper contemplates extension of PQ regulation to other water entities at a later date. We note, in any event, the clear links between PQ and ID regulation

5.1 Opportunity for smooth transition

The statutory deadlines driving the timetable for Watercare do not apply to other entities. This means the Commission has an opportunity to plan for and execute a more conventional implementation for other water entities.

That might entail:

- establishing IMs (or clear rules in lieu of IMs) up front for both ID and PQ. This includes all the matters typically addressed through the ID and PQ IMs
- deciding as soon as practical, which entities will be subject to which form of PQ regulation and providing lead-time for preparation. For example:
    - IPP for larger entities: requires longer lead time for PQS preparation than entities subject to DPP
    - DPP for smaller entities: requires less lead time as limited action required of entities, but more reliant on information received through ID
    - ID-only for very small entities
- completing the first cycle (or two) of ID to build (a) base capability within water entities (b) a base of information for the Commission (especially for DPP firms)
- phase implementation for entities subject to IPP regulation to smooth workload for the Commission, and the wider ecosystem of advisers (to it, regulated entities and affected parties)
- coordinate phasing with other PQ resets (electricity, gas, fibre) and IM reviews.

Our experience is that where multiple resets and or IM reviews coincide, outcomes for consumers are put at risk. That is because the Commission is over-stretched and unable to engage in depth or soon enough. We note the Commission has taken steps to better coordinate the phasing of PQ resets and IM reviews, there is an opportunity to design this into the water sector regime.

5.2 Optimising sequencing, smoothing peaks

The table below shows the current sequencing and timing of PQ resets and IM reviews and how application of PQ for water might be dove-tail into this work programme.

Entity / sector	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33
Transpower									
Chorus									
EDB DPP									
Gas DPP									
Watercare IPP									
Water IPP x2									
Water IPP x2									
Water DPP									
CPP applications		Evaluate on receipt							
Reopeners / ICP / MCP		Evaluate on receipt							
Electricity and gas IM review									
Fibre IM review									
Set water IMs									

Notes: Yellow = main Commission evaluation task. Assumes a 4 year PQP1 for all water entities. Suggests water IMs could be developed alongside scheduled IM reviews for other sectors.

5.3 Picking the right horse for the course

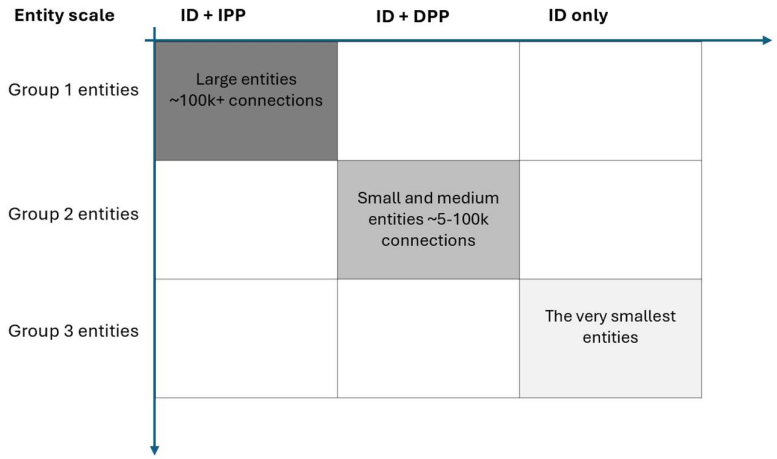
In due course the Commission will decide whether to recommend extension of PQ regulation to other water entities.

In doing so it will likely evaluate the costs and benefits as part of a regulatory impact assessment.

That is likely to identify that:

- IPP regulation is costly for the regulated entity and the regulator. These costs are relatively small in the context of large entities while the benefits are potentially large.
- Potential benefits broadly scale with entity size, but compliance costs do not. That means a smaller entity will incur similar compliance costs, but the benefits will be lower. In other words, there is a minimum viable scale for IPP regulation.
- For entities below that minimum scale, a lower cost price quality models, such as the DPP model applied to most electricity and gas networks, may still be net beneficial.
- There may be some entities for whom PQ regulation is not beneficial for cost or other reasons. For example, electricity distributors owned by consumer trusts[7] are exempt from price quality regulation.

The diagram below illustrates of delineation might be made between the PQ model applied (or not) do different entities.



We note that the decision to exempt electricity distribution businesses from price-quality regulation related to ownership rather than entity size. The smallest price quality regulated business has less than 5000 customers.

[7] Distributors that were owned by councils, privately owned, listed or under other ownership structures are not exempt from price quality regulation.

Appendix A. PQS development

General observations

We provide links to several reference resources that we think will aid Watercare's appreciation of typical PQS requirements.

This information is useful in terms of 'what' is required but does not illuminate the 'how' Watercare goes about preparing the PQS.

Concept can provide further insight here if useful. That would draw on direct experience contributing or leading four of the five individual price path submissions to, and within regulators evaluating price quality proposals.

We note:

1. to meet PQS requirements, entities often need to develop or at least formalise and document business processes, practices, policies and forecast models.
2. significant effort is required to bring staff, management and Directors up to speed so they may correctly (and compliantly) do what is required to prepare, then certify the PQS.
3. this is particularly true for the first PQS, though not uncommon for subsequent PQS's as requirements change and regulator expectations increase.

Resources

Chorus – fixed line fibre access services

The example we think most pertinent is Chorus which, like Watercare, had to prepare its first PQS while IMs and other PQS specific rules were being developed. Chorus is in its second PQP and is preparing its 3rd PQS for PQP3 (starting 2029).

Chorus consolidated IMs, including the Chorus Capex IM which specifies information and procedural requirements for capex component of PQS and certain other capex reopeners and processes. This should be read in conjunction with:

Chorus section 221 notice for PQP2

Tripartite deed for Independent Verifier

IV report

Journey to set Chorus's 2nd price path

Transpower – electricity transmission services

Transpower is in its 4th PQP which runs until 2030.

Transpower consolidated IMs, including the Transpower Capex IM which specifies information and procedural requirements for capex component of PQS and certain other capex reopeners and processes. This should be read in conjunction with:

Section 53zd opex notice

Section 53zd revenue calculation notice

Tripartite deed for Independent Verifier

IV report

Journey to set Transpower's 4th price path

Appendix B. Options to reduce pressure, buy time

May be a combination of several of these options:

	Option	Rationale	Pros	Cons	Comment
1	Skip IV for PQP1	IV is a time / resource intensive exercise, is done when proposal is substantively complete, which means difficult timeframes.	Buys ~6+ months	Less rigour, more for CC	'No rules' makes IV problematic, precedent with Transpower (no IV until PCP3) and Chorus (no IV until PCP2).
2	Skip or permit simple engagement for PQP1	To be meaningful, need to be able to present PQ trade-off, not able to do effectively until revenue model known.	Reduce pressure	Lose input, buy-in	Scope for some engagement, need to recognise process driven limitations.
3	Truncate CC evaluation for PQP1	If retain IV, then rely on this and truncate evaluation. Allows shortening of evaluation window.	Buys ~3-6 months	-	Intention is for IV to alleviate Commission evaluation task.
4	Skip or scale back audit for PQP1	Retain computational accuracy. Soften / remove compliance with IMs / information notice.	Remove an infeasibility	May not be avoidable	Compliance audit difficult with new / no rules. However, does give assurance to Directors so removal increases burden on mgmt. to demonstrate compliance.
5	Declare existing IMs can be adopted as interim	Most requirements in most IMs will be required for Watercare. If no rules, Watercare is left guessing, at mercy of Commission who will not have rules either.	Reduce pressure, provide clarity, buys ~6-24 months	Not tailored to Watercare	Adopting existing IMs makes sense, have 'rapid' process for necessary exceptions or tailoring that can be agreed between the parties.
6	Avoid GAAP divergence wherever possible	Alignment with GAAP reduces need for data transformations / complex modelling. Also, GAAP understood by business.	Avoid undue complexity	Reduces scope for customisation	Multiple low value departures from GAAP have driven cost, complexity, compliance risk.
7	Short period, transition year(s) e.g. rolling over key Charter features (e.g. final revenue allowance) to PQP1	Reduce risk of lower maturity PQS, as per Transpower and Chorus 1st IPPS.	Reduce risk	Less certainty	Also allows firm to 'roll into' 2nd PQS preparation after PQP1 starts, maintain continuity and learning.

8	Evaluation pragmatism	Recognise PQS will have deficiencies and not punish Watercare for this.	Confidence to Watercare	Risk to consumers	Requires trust, and good faith / discipline by both parties.

Adopt existing IMs as guidance for PQP1

IMs for asset valuation, cost allocation, depreciation, taxation, cost of capital and quality dimensions are substantially the same for each of the PQ regulated entities. They can, for the most part be adopted by Watercare as guidance in key areas, until such time as water-specific rules / IMs are available.

However, there are only two IPP regulated firms, Transpower and Chorus. As a start point, the following IMs could be adopted as guidance for Watercare in preparing its first PQS:

	IM	Proxy IM	Comment
1	Asset valuation	Transpower	Could probably be any of the existing IMs
2	Cost allocation	Chorus	Multi-service, significant and complex allocation task.
3	Depreciation	Transpower	Transpower IM allows for depreciation in year of commissioning. Note: depreciation rules are key source of complexity / confusion / risk.
4	Taxation	-	TBC if required
5	Cost of capital	Transpower	Risk profile arguably closest to Transpower of all regulated entities
6	Capex	Chorus	No Voll, GRS, Chorus has requirements to satisfy more general prudency and efficiency tests.
7	Quality dimensions	Chorus	Multi-dimensional nature of service closest to fibre services.
8	Specification of price and revenues	Chorus	Suggest Chorus a good reference – IPP with large PQ customer base, significant revenue from capital contributions, significant non-regulated revenue.

We expect an equivalent of the section 53zd (Transpower) or section 221 notice (Chorus) will be necessary for opex and other information the Commission might require Watercare to include in its PQS. Until this is prepared, one of these notices might be adopted as guidance by Watercare.[8]

[8] Through these notices, the Commission has the power to ask for additional information Transpower and Chorus are not required to provide under their respective IMs.

In adopting existing IMs for guidance, Watercare will need to interpret certain provisions so they are applicable to water. That is necessary but should be done by agreement with the Commission to ensure alignment and avoid misunderstanding or future dispute.

Appendix C. Other PQ rules and mechanisms

	Price quality rules and mechanisms (Chapter 5 of approach paper)	Comment
1	Quality standards and performance requirements, as well as any associated incentives	Define QS framework ASAP. Defer financial incentives (QoS, efficiency, delivery) to PQP2.
2	Expenditure forecasts, as well as any associated incentives	Adopt adapted Chorus requirements (Capex IM, section 221 notice, regulatory templates).
3	Scope of prices, tariffs and charges to which maximum revenue limits derived from the BBM will apply, including whether separate limits apply to water supply and wastewater charges, as well as the treatment of IGC revenue (e.g., as an offset to the RAB)	
4	Any minimum revenue limits, or maximum or minimum price limits, to complement the maximum revenue limits determined using the BBM	Suggest a rule rather than $ limit most appropriate, possibly financial metric e.g. debt : revenue, debt : EBITDA, debt : free cashflow.
5	'Forms of control' for implementing revenue or price limits (eg, revenue caps/floors, weighted average price caps/floors, individual price caps/floors), which can affect the extent to which Watercare or its customers are exposed to the risk of demand for regulated water services differing from expectations about demand when the path was set	Suggest revenue cap, possibly with (simple) volume adjustment for connections / other major cost driver.
6	Wash-up mechanisms, which allow for under- or over-recovery of revenue to be recovered from or returned to consumers in later years	Suggest adopt existing wash-up, Chorus may best reflect Watercare's circumstances.
78	Smoothing mechanisms to mitigate price shocks and support financing	If required, noting comments in main report.
9	Provisions relating to reporting on or giving effect to pricing methodologies— eg, Watercare has committed to implementing a new IGC pricing methodology	Main reporting vehicle should be ID. PQ specific reporting may be required for one-off requirements.
10	Date or dates on which the PQP (or any part of it) takes effect,76 and the regulatory period to which the PQP applies	Specify ASAP.
11	Reporting and compliance requirements, including timing for demonstrating compliance	Adopt Chorus reporting requirements.
12	Circumstances in which the path may be reconsidered during a regulatory period (ie, 'reopeners')	Suggest ICP (Chorus) and catastrophic event reopeners. EDB style reopeners not designed for IPP regulation.
13	Regulatory templates that specify how data is presented to the Commission including categories and detailed requirements, information notice specifies what information must be provided alongside the 'base capex proposal' requirements specified in Capex IM.	**[note: not covered in approach paper but important for PQS preparation]** Early clarity essential as this is foundational to how Watercare goes about preparing inputs to PQS.