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Commerce Commission
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Via email: wai@comcom.govt.nz

Tēnā koutou katoa

Price-quality path for Watercare – Emerging Views Paper

Water New Zealand (Water NZ) welcomes the opportunity to comment on the Commerce Commission's Emerging Views Paper (EV Paper) on Watercare's first Price-Quality Path (PQP28). Water NZ is the national industry body for New Zealand's drinking water, wastewater and stormwater sectors. Our approximately 3,600 members represent the breadth of the industry, including water service providers, territorial authorities, regional councils, consultants, contractors, suppliers, researchers, government agencies and other organisations involved in the planning, delivery and regulation of water services.

We acknowledge the significant work undertaken since the release of the Approach Paper and welcome the considerable refinement reflected in this EV Paper, particularly the Commission's expanded analysis of financeability and the additional transparency provided around its proposed regulatory framework. While the current proposals apply specifically to Watercare, their significance extends well beyond this one path. The principles the Commission settles here, on asset valuation, revenue sufficiency, expenditure assessment, financeability and the cost of capital, are likely to shape how the wider sector is regulated through information disclosure, the Commission's summary and analysis of that disclosure, and its broader regulatory expectations, regardless of whether and when price-quality regulation is applied to another provider. It is in that light that we raise the questions below. Our submission focuses not only on whether the proposed framework is appropriate for Watercare, but also on whether it establishes regulatory principles that are robust, proportionate and capable of supporting efficient investment across future regulated water service providers and the water sector as a whole.

Water NZ recognises that the issues considered in this submission involve genuine trade-offs, and we have sought to weigh those carefully in developing our positions. A durable regulatory framework must provide water service providers with sufficient and timely funding to invest efficiently and manage risk, including risks that cannot yet be fully quantified, while maintaining appropriate downward pressure on the prices ultimately paid by consumers. We do not see these objectives as competing. Consumers' long-term interests depend not only on affordable charges today, but also on a financially sustainable water sector capable of delivering reliable services and efficient investment over successive decades. Throughout this submission, we have therefore sought to balance two equally important considerations: that the regulatory settings are sufficiently robust to support financeability and long-term investment, while remaining proportionate and mindful of the costs ultimately borne by consumers.

We welcome a number of the Commission's proposed refinements, including its increased focus on financeability, the move towards a physical Regulatory Asset Base (RAB) where supported by reliable information, and the additional analysis provided throughout the Paper. We nonetheless consider there remain several areas where further explanation, refinement or implementation guidance would strengthen confidence that the framework will achieve its objectives. Our submission is therefore organised around two overarching questions:

1. Do the proposed regulatory settings collectively operate as a coherent and financeable framework capable of supporting the significant long-term investment the water sector requires?
2. Does the proposed regulatory process provide sufficient certainty, transparency and proportionality to establish those settings effectively?

We recognise that this is an emerging views paper, and that the Commission's methodologies will continue to develop through to its draft and final decisions. Our recommendations are accordingly directed at the principles and directions we consider the draft decision should reflect. Overall, our recommendations seek to strengthen confidence that the proposed framework can advance the long-term interests of consumers by supporting a financially resilient water sector while maintaining transparent, proportionate and predictable regulation. Detailed feedback on each of these issues is set out below.

1. Fit-for-purpose settings that secure the sector's financeability

The Commission has appropriately recognised financeability as a central consideration in establishing Watercare's first price-quality path. Water NZ supports this direction. The ability of water service providers to efficiently finance long-term investment is fundamental to achieving the objectives of economic regulation and the broader reforms underway across the sector.

We acknowledge that the EV Paper has provided significant visibility and transparency around financeability through the proposed opening RAB, the Weighted Average Cost of Capital (WACC), and the Commission's dedicated financeability assessment. Water NZ nonetheless considers it is not yet fully demonstrated that the proposed package of regulatory settings collectively delivers a financeable and financially resilient framework capable of supporting the scale of investment anticipated across the water sector.

The following sections identify areas where further explanation or refinement would strengthen confidence that the proposed framework delivers a financeable and durable regulatory regime for both Watercare and future regulated water service providers.

1.1 Physical RAB: the 'reliable information' threshold

Water NZ welcomes the Commission's conditional preference for a physical opening RAB where it is supported by reliable information.

The EV Paper introduces the concept of "reliable information" as the threshold for establishing a physical RAB. However, it provides relatively limited guidance on the evidential standard providers will be expected to satisfy. In particular, it remains unclear what level of asset granularity, supporting documentation, reconciliation or independent verification will be sufficient for the Commission to conclude that information is reliable.

Water infrastructure comprises long-lived assets developed and maintained over many decades through successive governance and organisational arrangements. The quality, completeness and format of historical asset information will therefore vary across providers, and even where information is relatively strong, assembling and demonstrating that it satisfies a new regulatory evidential standard will require significant effort and clarity.

Without greater clarity on the Commission's expectations, providers may either over-invest in assembling evidence beyond what is necessary, or under-invest and face the risk that a proposed physical RAB is subsequently found not to satisfy the Commission's evidential threshold. Both outcomes increase implementation uncertainty, compliance costs and regulatory risk, which are ultimately borne by consumers.

Water NZ recommends that the Commission:

a. publish clearer guidance on the evidential standard required to establish a physical opening RAB, including the level of asset granularity, supporting documentation and reconciliation expected to demonstrate that information is reliable; and

b. provide greater transparency on how it will determine when a physical RAB is no longer capable of being implemented reliably and a modelled RAB becomes appropriate.

c. consider whether, where historical asset information is incomplete, a "sufficiency and reasonableness" test could support the establishment of a physical RAB by assessing whether the available asset information, supporting evidence and governance arrangements provide a sufficiently reliable basis for regulatory decision-making, before defaulting to a modelled RAB.

1.2 The modelled RAB should be calibrated to the level of financial risk the framework expects providers to absorb

Water NZ accepts a modelled initial RAB as a legitimate fallback where the physical RAB approach cannot be implemented reliably. We note the Commission's acknowledgement that the physical RAB approach may be unique to Watercare because it relies on a recent, audited vesting value, whereas a modelled RAB is likely to be more appropriate for many of the water service providers that follow (paras 4.39–4.40). Calibrating the modelled RAB is therefore not simply a question for Watercare's fallback position as it is likely to establish an important precedent for much of the wider sector.

Water NZ notes that the modelled RAB methodology is calibrated to satisfy the proposed financeability metrics at the commencement of PQP28. It is derived by starting from forecast 2028 debt, adding an equity buffer to a target gearing level, and adjusting the remaining asset life until forecast cashflows satisfy the target FFO/net-debt range (para 4.27). Where multiple values satisfy those criteria, the Commission's efficiency criterion favours the option with the lowest present value of revenue (para 4.32.4). It is therefore not apparent what level of financial resilience or headroom is intended to remain once those metrics have been satisfied, or whether the resulting opening position has been calibrated to absorb the short-term financial risks the wider framework expects providers to carry before a reset or other regulatory intervention becomes available (see section 1.4).

While the Commission provides mechanisms such as RAB roll-forward and future resets to support recovery over the longer term, financeability pressures arise when those risks materialise during the regulatory period. Where a thin opening position limits a provider's ability to finance efficient investment and respond to shocks while it awaits that longer-term recovery, the consequences are ultimately felt by consumers. Water NZ therefore considers the Commission should more clearly demonstrate that the methodology for the modelled RAB is consistent with the level of financial resilience and short-term risk the broader framework expects providers to maintain.

Water NZ recommends that the Commission:

a. demonstrate how the modelled RAB methodology is consistent with the level of financial resilience and short-term financial risk the broader regulatory framework expects providers to absorb before future resets, RAB roll-forward or other regulatory mechanisms become available.

1.3 The WACC framework should operate as a coherent and internally consistent model

Water NZ supports the Commission's use of an established benchmark methodology for estimating the WACC. The WACC is a fundamental building block of the price-quality path. Together with the opening RAB, it determines the return available to support investment and is therefore central to the Commission's conclusion that the proposed framework is financeable.

Our observation is that the EV Paper appears to apply different benchmark assumptions at different points in the framework, with limited explanation of how they collectively support the Commission's conclusions on financeability.

1.3.1 The WACC and financeability framework should consistently represent the benchmark regulated business

Water NZ takes no position on the level of the allowed return, the benchmark credit rating or benchmark leverage. Our observation relates to the internal coherence of the framework: the cost of debt is estimated on the assumption of a financially stronger benchmark business than the benchmark against which that return's financeability is then tested, and the EV Paper does not fully explain how the two fit together as a single benchmark regulated business.

The cost of debt is estimated using a benchmark credit rating of A- (para 5.36), whereas the financeability assessment is benchmarked against financial ratios drawn from Moody's Baa range (paras 4.53–4.54), a weaker credit standard. The net debt/RAB threshold is set at the 75% maximum of that Baa range (para 4.53), and the 9–13% FFO/net-debt range sits at or below Moody's Baa range of 11–18% (para 4.54).

EV Paper does not make explicit how the A- assumption used to price the return and the Baa-range metrics used to test financeability operate together as a description of one benchmark business. For example, how the margin of safety the A- assumption is said to provide is reflected in the financeability assessment, or whether the financeability metrics are intended to function as a floor a defined distance below that target. Making this relationship explicit would improve transparency without disturbing either figure. We note that this A- benchmark is more stringent than the BBB rating most overseas water regulators adopt (Table D.5; para D.46), which the Commission itself considers would provide a more modest margin of safety.

This matters for the wider sector, and not only for any provider that may later enter a price-quality path. In the Commission's other regulated sectors, the same core cost-of-capital parameters are used to set the WACC against which suppliers' information disclosures and in particular their returns on investment are assessed. Were a similar approach adopted for water, the benchmark relationship established here could inform how returns are assessed across all water entities, not Watercare alone. Setting that relationship out coherently now is therefore in the long-term interests of consumers across the sector.

Water NZ recommends that the Commission:

a. set out explicitly how the benchmark credit rating used to price the cost of debt (A-, para 5.36) and the financeability metrics drawn from the Baa range (paras 4.53–4.54) relate to one another as a description of a single benchmark regulated business, including how the margin of safety

the A- assumption is said to provide (para D.44) is reflected in the financeability assessment; and

b. more generally, demonstrate how the benchmark assumptions used to determine the allowed return and to assess financeability collectively represent a single, coherent benchmark regulated business, recognising that these settings are likely to inform future price-quality regulation across the wider water sector.

1.3.2 The selected WACC percentile should support the long-term interests of consumers

The Commission proposes to set the allowed return at the midpoint (50th percentile) of the estimated WACC range, on the basis that setting the return above the midpoint is unlikely to materially affect Watercare's investment incentives, because it cannot raise external equity or pay dividends and its investment is largely driven by statutory obligation (Executive Summary X26).

Water NZ does not advocate a particular percentile or level of return. Our interest is that the percentile is set on evidence of what serves the long-term interests of consumers. Under Part 4, consumers' interests are a combination of affordability and safe, reliable and resilient water services. Long-term affordability depends not only on efficient prices today, but also on sustained financial resilience to withstand shocks that ultimately roll over to consumers.

This is particularly important in the context of the water sector, which faces substantial infrastructure renewal requirements, increasing climate-adaptation costs, population growth and rising public-health and environmental expectations. These challenges require significant and sustained investment over many decades. The selected WACC percentile therefore has implications not only for current prices, but also for the sector's ongoing capacity to finance efficient investment in the long-term interests of consumers.

The Commission's framework recognises that any departure from the midpoint should be supported by evidence that it better promotes the long-term interests of consumers (para 5.44). The framework could benefit from a broader assessment of long-term consumer interests in the water-sector context. In its electricity regulation, the Commission has considered both the cost to consumers of higher prices and the long-term cost of under-investment and reduced service reliability when determining the appropriate WACC percentile. A comparable assessment of the long-term consumer costs associated with deferred investment, reduced resilience or service failure in the water sector would provide a stronger evidential basis for the percentile decision, whichever percentile that evidence ultimately supports (Para D.82).

Water NZ recommends that the Commission:

a. support the selection of the WACC percentile with evidence that considers both the benefits of lower prices and the long-term consumer costs of under-investment, reduced resilience and service failure, consistent with the purpose of Part 4.

1.4 Infrastructure growth charges: the framework should demonstrate resilience to short-term IGC uncertainty

The EV Paper proposes that differences between forecast and actual Infrastructure Growth Charge (IGC) revenue should not be reconciled during the regulatory period. Instead, providers would retain the short-term forecasting and timing risk, with any differences addressed over time through the roll-forward of the actual value of the RAB (paras 6.56–6.57). The Commission acknowledges this approach may create financeability pressures within the period and proposes, given Watercare's specific circumstances, a targeted, NPV-neutral financeability reopener where material and persistent financeability pressure can be demonstrated (para 6.58).

The Commission's stated reasons for not reconciling IGC variance within the period are consistency with the treatment of capital contributions in other Part 4 sectors and under the Charter, and the avoidance of long-term over- or under-recovery (paras 6.56–6.57). These are legitimate objectives, and Water NZ does not take issue with the risk-allocation principle. Our concern is narrower: the EV Paper does not clearly demonstrate that the broader financeability framework has been designed to support the level of short-term IGC risk providers are expected to retain before a reopener becomes available.

While IGC revenue differences may ultimately be recovered through future RAB roll-forward, financeability depends on whether providers can continue financing efficient investment while awaiting that recovery. The EV Paper does not explain the level of IGC forecasting variance or timing delay assumed within its financeability assessment. For example, it is unclear whether the framework has been tested against a 5%, 10% or 20% IGC revenue shortfall, or delays in receipt of one year, two years or longer. Without understanding the level of short-term risk the Commission expects providers to absorb, it is unclear whether the framework contains sufficient financial resilience before a reopener becomes necessary.

This has implications for consumers as well as providers. Consumers benefit from not paying in advance for growth that does not occur, but they also rely on providers remaining able to finance the infrastructure needed to accommodate growth, maintain service levels and meet statutory obligations. If short-term funding pressures constrain borrowing capacity or delay investment, the consequences are ultimately borne by all consumers through deferred infrastructure, slower connections, reduced network resilience or higher costs over time. The long-term interests of consumers therefore require an appropriate balance between efficient risk allocation and a financeable sector capable of delivering investment when it is needed.

The Commission's proposed reopener may provide an appropriate safeguard, but the EV Paper gives limited detail on how it would operate. Because the Commission itself describes it as targeted and NPV-neutral, clear targeting criteria are essential: greater clarity is needed on the level of financeability deterioration that would warrant intervention, the evidence a provider would be expected to demonstrate, and the timeframe within which the Commission would consider an application. Timing is particularly important, since a short-term cashflow shortfall requires a timely response. This matters all the more because the reopener is proposed for Watercare's specific circumstances: if the framework is

applied to future providers with differing financial capacity, growth profiles and borrowing constraints, it is important that comparable protection against short-term IGC risk is available where it is needed.

Water NZ recommends that the Commission:

a. state the level of IGC forecasting variance and timing delay assumed within its financeability assessment, including any implicit buffer for short-term shortfalls, and demonstrate that the financeability and allowable-revenue settings adequately reflect the short-term risk providers are expected to retain before the reopener becomes available; and

b. provide clearer guidance on how the proposed targeted, NPV-neutral financeability reopener would operate, including the thresholds for intervention, the evidence required, and, in particular, the timeframe within which it would respond.

2. A practical and proportionate regulatory framework

Water NZ supports the Commission's objective of establishing a robust economic regulatory framework for Watercare. As the first price-quality path under the new regime, the framework will also establish important precedents for future regulation across the wider water sector.

Accordingly, regulatory requirements should be proportionate to the risks they are intended to manage, practical to implement, and sufficiently flexible to recognise the differing scale, maturity and circumstances of current and future water service providers. We identify several opportunities where the regulatory process could be more streamlined or clarified while continuing to provide the Commission with the assurance necessary to perform its regulatory functions.

2.1 The absence of input methodologies raises the stakes, and the process should respond accordingly

The Commission has decided not to establish Input Methodologies (IMs) for the first price-quality path and has instead set out the key regulatory methodologies directly through the EV Paper. The Paper frames this first path as a learning exercise in an initial regulatory period. Water NZ welcomes the visibility the Paper provides, while noting that the absence of input methodologies increases the significance of transparency, stakeholder engagement, and opportunities to test the key methodologies before they become embedded in regulatory decisions.

However, the proposed process does not yet appear to fully reflect the learning and iterative objective the Commission states. Under the propose/respond model, Watercare is expected to prepare its proposal while several of the most significant regulatory settings, including the initial RAB, WACC and financeability framework, remain unsettled, and the Commission does not provide a formal step between these emerging views and the submission of that proposal at which they can be tested (para 1.6). In practice, if this framework does set precedents, this will leave providers developing proposals against multiple potential regulatory scenarios, increasing implementation uncertainty, compliance costs and delivery risk.

The trial character of this first regime is a reason to build more consultation into it, not less. Water NZ considers that greater consultation and engagement at this stage will strengthen, rather than delay, the development of the regime: it will improve confidence in the foundational methodologies, reduce implementation risk, and establish a stronger foundation for future economic regulation across the wider water sector. Greater regulatory certainty is also needed to give providers the confidence to prepare financeable proposals under the propose/respond model.

Water NZ recommends that the Commission:

- **a.** provide a structured opportunity for Watercare and any future regulated providers to test and give feedback on the foundational methodologies, the initial RAB, the cost of capital and financeability, before they are finalised through the first price-quality path;
- **b.** operate the propose/respond model as an iterative engagement process, enabling Watercare and any future regulated providers to respond to Commission feedback, clarify methodologies, provide further evidence and refine their proposals before final determinations are made; and
- **c.** signal its intention to develop water-specific input methodologies in due course and be transparent that the PQP28 settings are a starting point to be refined through that process rather than a settled rule.

2.2 The proposed assurance framework should clearly demonstrate how proportionality will be applied

Water NZ supports the Commission's emerging view that independent verification should be targeted and proportionate, focusing on expenditure that is material, higher risk or subject to greater uncertainty, rather than comprehensively verifying every aspect of a proposal (9.8).

However, we note that the EV Paper establishes the principle of proportionality but provides limited detail on how that principle will be applied in practice. In particular, it is not yet clear how the Commission intends to determine the scope and depth of verification, what thresholds will distinguish material from non-material expenditure, or how the expected regulatory value of additional assurance will be balanced against the additional cost ultimately borne by consumers.

The practical application of proportionality is also relevant to the Commission's proposed approach to scrutinising major capital projects funded through the Infrastructure Funding and Financing (IFF) mechanism (paras 3.28–3.30). Projects funded through the IFF mechanism are already subject to a separate statutory approval process. The EV Paper nonetheless proposes that these projects still be subject to the Commission's expenditure assessment process (para 3.29), yet it is not clear what additional regulatory assurance this second assessment is intended to provide, or what regulatory consequence would follow if the Commission reached a different conclusion on a project already approved through the IFF process. Without further explanation, there is a risk of duplicative regulatory scrutiny, increased compliance costs and regulatory uncertainty without a corresponding improvement in regulatory outcomes. In our view, the Commission could consider providing input into the IFF process rather than running a separate scrutiny process.

Water NZ recommends that the Commission:

a. set out how it will determine the scope and depth of independent verification including the thresholds distinguishing material from non-material expenditure, and how the regulatory value of assurance will be weighed against the cost to providers and consumers;

b. clarify how scrutiny under the price-quality path will interact with the Infrastructure Funding and Financing process, including the purpose of any additional assessment, the additional regulatory value it is intended to provide, and the regulatory consequences where different conclusions may be reached; and

c. confirm that assurance requirements will continue to be calibrated to the scale, complexity and regulatory risk of individual providers, rather than establishing Watercare's assurance model as the default for future price-quality paths.

Concluding remarks

Water NZ supports the introduction of price-quality regulation for Watercare and the Commission's objective of a durable, fit-for-purpose framework. In the absence of input methodologies, the decisions made through this first price-quality path will, in practice, shape economic regulation across the wider water sector for years to come. Our recommendations are directed at strengthening the framework so that it is coherent, financeable and proportionate for Watercare, and for the providers that will follow. We would welcome the opportunity to continue working with the Commission as the regime develops. If you have any questions about this submission, please contact us.

Ngā mihi nui



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Water New Zealand — submission on the Emerging Views Price-Quality Path for Watercare

Summary of issues raised and recommendations

Section	What we are raising	Our recommendations
1.1 Physical RAB — the "reliable information" threshold	The EV Paper makes "reliable information" the threshold for a physical RAB but it gives limited guidance on the evidential standard providers will need to meet. Water assets are long-lived and records vary across decades of organisational change. Regulated providers need clarity on level of asset granularity that will satisfy the reliable information threshold.	a. Publish clearer guidance on the evidential standard (asset granularity, documentation, reconciliation). b. Be transparent on when a physical RAB is no longer capable of being implemented reliably and a modelled RAB applies. c. consider whether, where historical asset information is incomplete, a "sufficiency and reasonableness" test could support the establishment of a physical RAB by assessing whether the available asset information, supporting evidence and governance arrangements provide a sufficiently reliable basis for regulatory decision-making, before defaulting to a modelled RAB.
1.2 The modelled RAB should be calibrated to the risk providers must absorb	The modelled RAB is calculated to satisfy the financeability metrics at commencement of PQP28, at the lowest present value of revenue (paras 4.27, 4.32.4). It is not apparent what financial resilience or headroom remains to absorb short-term risk before a reset and it is the likely route for future providers.	a. Demonstrate that the modelled RAB methodology is consistent with the financial resilience and short-term risk the framework expects providers to absorb before future resets or RAB roll-forward.
1.3.1 Consistency of the benchmark business (WACC vs financeability)	The cost of debt is priced on an A- credit rating (para 5.36) while financeability is tested against ratios drawn from Moody's weaker Baa range (paras 4.53–4.54).The Commission's "margin of safety" rationale for A- is noted (para D.44), but the EV Paper does not make explicit how the same business can be treated as financially strong when the return is set, yet weaker when its financeability is	a. Set out explicitly how the A- debt-pricing rating and the Baa financeability metrics relate as one benchmark business, including how the margin of safety is reflected.

Section	What we are raising	Our recommendations
	tested. Because the same cost-of-capital parameters set the WACC against which providers' information disclosures are assessed in other sectors, the benchmark relationship established here could shape how returns are viewed across all water entities	b. Demonstrate that the benchmark assumptions collectively represent a coherent benchmark regulated business.
1.3.2 The WACC percentile should support the long-term interests of consumers	The Commission justifies the midpoint WACC on the basis that a higher return is unlikely to change Watercare's investment incentives in this period (Executive Summary X26). While this may address consumers' short-term prices, it may not address the impact of financial pressure on the sector's ability to invest and meet levels of service, which ultimately affects consumers' long-term interests.	a. Support the percentile with evidence weighing lower prices against the potential long-term consumer costs of under-investment, reduced resilience and service failure (as in electricity) whichever percentile that evidence supports.
1.4 Infrastructure growth charges (IGC)	IGC forecasting variance is not reconciled within the period; providers instead retain the short-term risk, which is reconciled over time through the RAB roll-forward (paras 6.56–6.57). The Paper does not show what level of variance the financeability framework was tested against, and the proposed reopener do deal with potential financial pressure (para 6.58) lacks operating detail.	a. State the IGC variance and timing delay assumed, and demonstrate the settings absorb the short-term risk retained before a reopener becomes available. b. Provide clearer reopener guidance, thresholds for intervention, evidence required, and, in particular, the timeframe to respond.
2.1 Absence of input methodologies, and the process	Without input methodologies, transparency and the opportunity to test key methodologies matter more than they otherwise would. Yet under the propose/respond model, providers must prepare their proposals while the most significant settings remain unsettled, with no formal step at which those settings can be tested first (para 1.6).	a. Provide a structured opportunity to test the foundational methodologies before they are finalised. b. Operate propose/respond as an iterative engagement process. c. Signal intent to develop water-specific input methodologies in due course.

Section	What we are raising	Our recommendations
2.2 Proportionality of the assurance framework	The proportionality principle is established (paras 9.8) but its application is unclear. IFF-funded projects, already approved through a separate process, would be re-scrutinised through the price-quality path (paras 3.28–3.30).	a. Set out how the scope and depth of verification will be determined. b. Clarify how price-quality-path scrutiny interacts with the IFF process. c. Confirm assurance is calibrated to each provider, not defaulted to Watercare's model.