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Matthew Clark
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Sent by email to: regulation.branch@comcom.govt.nz

18 September 2019

Dear Matthew

Powerco submission on *Treatment of operating leases - Draft decisions and reasons paper*

Powerco appreciates the opportunity to provide feedback on the Commerce Commission's Draft decisions and reasons paper of 28 August 2019 (Draft Decision). We have summarised our position below, then provide detailed comments on two issues:

1. **Rolling off our CPP to DPP3, and**
2. **Forward-looking IM changes.**

The Draft Decision paper is complex, so we appreciate the Commission's efforts to model and communicate the inter-related issues in a limited timeframe. We also appreciate engagement from Commission staff to help us clarify the mechanics of the proposed solution. While we remain confident in our understanding of the intent of the Draft Decision, the translation of these principles to implementation remains ambiguous in places. Based on our current understanding, our position on the Draft Decision is:

We continue to support alignment with GAAP

- We agree with the decision to assign a GAAP-based life to network right of use assets.
- We agree with the decision to assign a GAAP-based opening deferred tax balance.

The proposal is complex but workable

- We agree with the intention to retain the existing IM treatment of pass-through costs and recoverable costs.
- While we interpret the proposed mechanism to treat operating leases as opex for IRIS as complex, we agree with the Commission's conclusion it is workable.
- We acknowledge the pragmatic shift to defer the impact of the Draft Decision to the next regulatory period.

Impact on Powerco rolling off CPP to DPP3

The Draft Decision makes it clear that the impact of the IM amendments will take effect from the start of the next regulatory period. For distributors subject to a DPP the impact will be observed from 1 April 2020. However, as Powerco is on a CPP our next regulatory period doesn't begin until 1 April 2023. The process for rolling off our CPP to DPP3 has not commenced, so our assessment of the Draft Decision requires making assumptions about issues that we have not yet worked through with the Commission. Despite this, in the spirit of providing constructive input, we've still had a crack at the exercise.

We have interpreted the Draft Decision to require Powerco to make appropriate adjustments to our 2022 base year expenditure before it affects our price-path commencing 1 April 2023. From this date our IRIS modelling consistently:

- aligns forecast and actual operating expenditure to include operating leases.
- aligns forecast and actual commissioned assets to exclude right of use assets.

The estimated net IRIS benefits appear to be driven by:

- a (large) opex IRIS payment in FY24, due the reduced carry forward amount from FY19; and
- the capex IRIS benefits due to the underspend during the CPP period which impacts the period FY22-30.

We are keen to work with the Commission on how this dynamic works. For example, clarifying Powerco's effective date and our modelling approach and assumptions as there could be material costs depending on the interpretation.

Forward-looking IM changes

We support the Commission's position that changing the IMs to prevent early adopter and CPP distributors from gaining a benefit would risk undermining the certainty that is otherwise provided by the IRIS IM.

The Draft Decision noted that Powerco was an early adopter of NZ IFRS 16¹. Powerco adopted NZ IFRS 16 on 1 April 2017 and the impact was reflected in our statutory financial statements and regulatory disclosures from the year ending 31 March 2018. The decision on the timing of our transition to this new standard was made with reference to the timing of other major projects; including a significant investment to implement a new ERP system. Phase 1 of this system has been delivered in 2019, the same year as mandatory adoption of the new accounting standard. Our decision to adopt NZ IFRS 16 early was prudent as it ensured resources would be available for all competing priorities and to avoid any unintended consequences during ERP implementation.

As an overarching point, the regulatory framework is increasingly complex and requires more costly resources for distributors to administer. Yes, we still support the Draft Decision. We are also mindful of the cumulative impact from incremental changes to our regulatory framework, especially those that require different treatment for Information Disclosure and IRIS. We can work with this complexity, but others may find it challenging which will ultimately cost consumers more than it ought to.

¹ New Zealand Equivalent to International Financial Reporting Standard 16 Leases (NZ IFRS 16)

If you have any questions on this submission, or would like to discuss these issues further, please contact Leisa Patel (Leisa.Patel@powerco.co.nz).

Yours sincerely

A handwritten signature in blue ink, appearing to be 'Stuart Marshall', written in a cursive style.

Stuart Marshall
General Manager Regulation and Commercial