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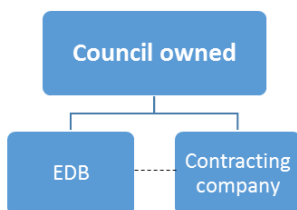
By email: regulation.branch@comcom.govt.nz

NETWORK WAITAKI COMMENTS ON THE INPUT METHODOLOGIES REVIEW. DRAFT DECISION ON RELATED PARTY TRANSACTIONS

Thank you for the opportunity to comment on the *Input methodologies review draft decisions – Related party transactions, 30 August 2017 (draft decision)*.

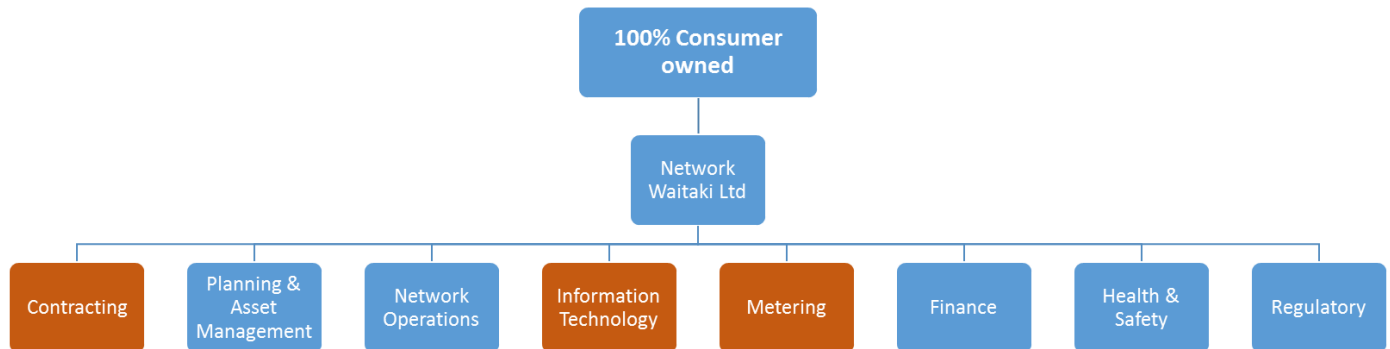
Definition of “related party”

- 1) The focus of our comments pertains to the Commerce Commission’s interpretation of the current definition of related party and the inclusion of a second limb to the definition, namely that a related party includes “*Any part, branch or division of the EDB that does not supply electricity distribution services*”. The example used on page 58 of the draft decision states that “*the entity that operates the electricity lines service also has a contracting division which provides a range of repairs and maintenance, vegetation management and minor capex builds to the regulated service is considered a related party for regulatory purposes.*”
- 2) We do agree that there is a reporting responsibility where a real related party relationship exist as in the following hypothetical example:



In this illustration, the EDB and the Contracting company are subsidiaries of the parent company which is the Council. The EDB and the contracting company are clearly related parties and there is a risk of the EDB giving the related party preference above independent parties. It is clear why it is important for the EDB to make the necessary disclosures to provide comfort to the Commerce Commission and electricity consumers that transactions are at arms-length.

- 3) In contrast, the following diagram illustrates Network Waitaki Ltd's (NWL) ownership and organisational structure.



The clarification and example in the *draft decision* of a related party refers to a “part of an EDB” which appears to include internal business units. In NWL’s case this means that the contracting unit and even the metering unit or information technology unit could be viewed as related parties as they are not supplying electricity distribution services directly but support services.

- 4) As the draft decision specifically highlights “a contracting division, part or branch” in the example we would like to provide some background on our situation. Network Waitaki Contracting Ltd amalgamated with NWL at the end of the 2015 financial year. The main reason for the amalgamation was firstly to achieve better operational efficiency through reducing operating cost, redundant processes and achieving integration of work processes. Secondly, the amalgamation achieved better effectiveness in terms of synergy gains, namely improved coordination, work scheduling and service delivery. Through the amalgamation, the shareholders of NWL, namely electricity consumers benefited through better service at the lowest cost.
- 5) The NWL Contracting business unit operates at cost (zero profit) except where it occasionally does work for third parties. Irrespective of this, any benefit or profit accruing to any business unit affects the bottom line of NWL to the benefit of its shareholders, the electricity consumers.
- 6) It will be helpful if the Commerce Commission could expand on their definition of a “part, branch or division”. Are there any thresholds or materiality levels that can be used for guidance like say Net Profit Before Tax (NPBT) is greater than 20% of the total NPBT for the company it is a part of?
- 7) Any revenue from third party work is excluded in any case for information disclosure purposes in line with the Input Methodologies’ requirements.
- 8) Furthermore, NWL applies the Accounting-based allocation approach (ABAA) to allocate cost between regulated and unregulated services.
- 9) We understand the Commerce Commission’s policy intent as set out in paragraph 2.39, namely to “ensure that the value of a good or service acquired by the regulated service from a related party, or the value received from the sale or supply by the regulated service of an asset or service to a related party, is disclosed on the basis that: each related party transaction is valued as if it had the terms of an arm’s length transaction; and the value of a related party transaction is based on an objective and independent measure”. However, we do not understand how the Commerce Commission will achieve the intent of paragraph 2.39 by including internal business units as related parties. On the

contrary, this inclusion will complicate the already complex information disclosure process and add to compliance and audit cost with no obvious benefit to consumers.

10) The definition of related party differs from the definition as per the NZ IAS 24¹. We realise that there might be a difference in intent between regulatory and accounting bodies but believe there should be some consistency.

11) NWL supports submissions by the Electricity Networks Association (ENA) and PriceWaterhouseCoopers (PwC) in this regard.

Impact of compliance cost

12) We are strongly of the opinion that the benefit of complying to the “arms-length transaction value tests” for our internal business units will not justify the cost and could affect network prices because we will have to consider additional resources to comply. This will be ironic, as the main intention of amalgamation of the businesses was to improve efficiencies.

This is a real issue for us and we would welcome further discussions regarding any questions that you may have for clarity regarding our situation.

Regards

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¹ New Zealand Equivalent to International Accounting Standard 24 *Related Party Disclosures* (NZ IAS 24)