
Submission to the Commerce Commission

on

Consultation on Electricity and
Gas Input Methodology
Determination Amendments 2012

Final
1 June 2012

Made on behalf of 22 Electricity Distribution Businesses



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Introduction

1. This paper forms our submission on the Commerce Commission's (the Commission's) paper entitled "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012" (the Consultation Paper).
2. This submission has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 22 Electricity Distribution Businesses (EDBs):
 - Alpine Energy Limited
 - Aurora Energy Limited
 - Buller Electricity Limited
 - Counties Power Limited
 - Eastland Network Limited
 - Electra Limited
 - Electricity Ashburton Limited
 - Electricity Invercargill Limited
 - Horizon Energy Distribution Limited
 - MainPower New Zealand Limited
 - Marlborough Lines Limited
 - Nelson Electricity Limited
 - Network Tasman Limited
 - Network Waitaki Limited
 - Northpower Limited
 - OtagoNet Joint Venture
 - Scanpower Limited
 - The Lines Company Limited
 - The Power Company Limited
 - Top Energy Limited
 - Waipa Networks Limited
 - Westpower Limited.
3. These businesses together supply 30% of electricity consumers, own 48% of the total distribution network length,¹ and service 74% of the total network supply area in New Zealand. They include both consumer owned and non consumer owned businesses, and urban and rural networks located in both the North and South Islands.
4. The Consultation Paper proposes amendments to the December 2010 Input Methodology determinations (IMs) which apply to EDBs and gas pipeline businesses (GPBs). This submission is limited to the proposed amendments which are relevant to EDBs, namely the treatment of asset acquisitions from related parties in respect of the asset valuation IMs.
5. We appreciate the opportunity to comment on the draft amendments. We trust that this submission provides useful input for the Commission in further developing and implementing its obligations under Part 4 of the Commerce Act. We would be happy to answer any questions you may have regarding this submission, and would welcome the opportunity to discuss the points raised further with the Commission as the consultation process proceeds.
6. The primary contact for this submission is:

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¹ These figures are based on 2011 information disclosures (using the 2010 values for Orion).

Asset Valuation Input Methodologies

7. The EDB asset valuation IMs for information disclosure regulation (IDR) are set out in Part 2 of the IM determination,² and for customised price-quality path (CPP) regulation, in Part 5 of the IM determination. An asset valuation IM for Default Price-Quality Path (DPP) regulation has not yet been determined and is subject to a separate work stream which is currently underway.
8. The asset valuation IM comprises the following core components:
 - Establishment of an Initial (opening) Regulatory Asset Base (RAB), as at 1 April 2009; and
 - A methodology for rolling forward the RAB each year with annual adjustments for additions, depreciation, revaluations, disposals, lost and found assets, asset sales and acquisitions.
9. The Part 2 asset valuation IM for IDR specifies the value of asset additions, acquired assets and vested assets in clause **2.2.11 Value of Commissioned Assets**. A similar clause exists in Part 5 for CPP regulation, the key difference is that Part 5 accommodates forecast information, whereas Part 2 is limited to historical information. For the purpose of this submission we will focus on Part 2, although our comments are also relevant to Part 5.
10. For the most part, the value of commissioned assets is to be recognised in accordance with GAAP. This reflects an intention to rely on the rules set out in GAAP for identifying the cost of an asset. This enables regulated suppliers and their auditors to use existing GAAP compliant systems and processes for establishing the value of commissioned assets. It also helps to ensure that regulated suppliers derive information on a consistent basis. In addition, applying GAAP for regulatory purposes assists interested persons to understand regulatory financial information because GAAP is widely understood by users of financial information.
11. A limited number of departures from GAAP are included in clause 2.2.11, where the Commission deemed they were more consistent with the Purpose of Part 4. As a general rule, the EDBs which support this submission do not support departures from GAAP, unless there is a clear and material benefit in doing so, because of the additional compliance complexity which this introduces. We note that it is possible to prescribe specific regulatory treatments which are not inconsistent with GAAP, but which may not be explicitly addressed in GAAP. We support such an approach in meeting regulatory objectives where possible, because of the compliance cost advantages.

Information Disclosure Requirements

12. The proposed amendment to the asset valuation IMs addresses the value of assets acquired from related parties. This proposed change has arisen partly as a result of the ongoing review of IDR. In this respect, the EDBs which support this submission have previously submitted their views on the treatment of related party transactions in the context of IDR.³
13. The current IM consultation is limited to the treatment of acquisitions from related parties. This proposed amendment will have no impact on the value of assets acquired from unrelated parties or those constructed in-house by EDBs. Assets acquired are a subset of a range of related party transactions which have been the subject of the IDR consultation. It is somewhat difficult for us to reconcile this current consultation with the parallel process for IDR. The Consultation Paper acknowledges the IDR submissions on this topic but does not draw a link between them and the proposed amendments to the IMs. In addition, the IM proposal puts forward a number of thresholds and rules to determine whether related party transactions are material or based on arms length principles. Thresholds and rules also formed part of the draft IDR proposals however the ones included in the Consultation Paper differ to those that were in the Draft Determination

² Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010

³ PwC on behalf of 22 EDBs, Submission to the Commerce Commission on Draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination 2012, dated 9 March 2012

for IDR.⁴ They also differ to those which were included in the ENA's IDR submission,⁵ which were endorsed in our IDR submission.

14. Accordingly our comments in this submission are limited to our understanding of the scope of the proposed amendments to the asset valuation IM without consideration of the broader context for IDR or CPP regulation.

Acquisitions from Related Parties

15. The existing asset valuation IM requires assets acquired from related parties to be included:
- At the Depreciated Historical Cost (DHC) of the related party, as determined by applying GAAP, at acquisition date; or
 - Where insufficient records exist, its market value at commissioning date, as determined by a valuer.
16. It is now proposed that assets acquired from related parties are included:
- At cost to the EDB, determined in accordance with GAAP, where the EDB is able to provide evidence that asset acquisitions are immaterial or the relevant transactions meet arms length principles (by applying a set of rules); otherwise
 - At DHC (as above) provided sufficient records are available; or
 - Market value at commissioning date, as determined by a valuer; or
 - In all other cases nil.
17. We support the intent to offer additional options for valuing related party transactions to those included in the current IMs.
18. In our earlier IDR submission we considered that related party transactions should be included at transaction cost, and that the purpose of IDR is best met by sufficient information being made available to interested persons to assess how the transaction cost was determined. We believe this principle is also relevant for a CPP proposal, as the Commission has the ability to assess such information and if necessary modify the proposed expenditure as part of its CPP approval process. We endorsed the ENA's proposal for the following information requirements to apply for related party transactions for the purpose of IDR.
- *All related party transactions are included at transaction cost;*
 - *Existing disclosure requirements remain; and*
 - *In addition, where the related party transaction does not meet the criteria set out in i) – iv) below the EDB must disclose how prices are set for the relevant goods and services provided.*
 - i. The related party makes at least 50% of sales to other parties, at similar prices for similar services; or*
 - ii. Services which are provided in a related party arrangement were previously outsourced and the cost of supply is the same or less than previously outsourced costs; or*
 - iii. The value of all transactions with a related party is less than 20% of the EDB's regulated revenue for the year; or less than 15% of opex or capex for the year (as appropriate); or*
 - iv. A certified tender has been undertaken (and supporting documentation exists) and Directors certify that a competitive tender process was undertaken; with a least one competing proposal; all tenderers were considered equally and the decision to hire was made on the commercial merits of the competing bids.*
19. This remains our preferred approach to establishing the cost of related party transactions for the purpose of IDR and CPPs. Notwithstanding this view, the Consultation Paper proposes that transaction cost may only

⁴ Commerce Commission, Draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination 2012, 16 January 2012

⁵ ENA, Submission on Information Disclosure Requirements for Electricity Distribution Businesses: Draft Determination and Draft Reasons Paper, 9 March 2012, paragraph 127

be assigned to related party asset acquisitions if certain materiality thresholds or arms length rules are met. Without prejudice to our view that related party transactions should be included at transaction cost, we have considered the reasonableness of the alternative approach proposed by the Commission. In this respect we endorse an approach which allows, where possible, related party transactions to be included at cost to the EDB, determined in accordance with GAAP.

20. Materiality thresholds and rules are useful mechanisms for implementing a methodology in a practical way. The usefulness of the approach however depends on the reasonableness of the thresholds, rules and the alternatives available if the thresholds and rules are not able to be met. We believe that the rules set out in the ENA's IDR proposal could be adopted if the Commission proceeds with its proposed approach.
21. The Consultation Paper does not explicitly consider the range of related party transactions which may occur in respect of assets. It is necessary to do this to determine whether the proposals are reasonable. However, in order to do this we have had to infer from the Consultation Paper the Commission's expectations about the range of transactions which could be captured by the proposed new provisions. We anticipate that there are three possible types of asset related transactions between an EDB and a related party which could be captured by the new provisions, as follows:
 - i. A purchase of an asset by an EDB which is currently in use by a related party, for example, a vehicle owned by a related contracting entity;
 - ii. A purchase of material components by an EDB, which are supplied by a related party, to be installed or incorporated into a construction project undertaken by the EDB (or a service provider to that EDB), for example, the supply of transformers by a related party manufacturer or supplier; and
 - iii. Construction services undertaken by a related party contractor to the EDB, for assets which are to be commissioned by the EDB.
22. We have considered the reasonableness of the proposed thresholds and arms length rules for each of these types of transactions in Table One overleaf. If assets meet one or more of the materiality thresholds or one or more of the arm's length rules set out in the proposed clause 2.2.11(5), they are to be valued in accordance with clause 2.2.11(1). This clause allows assets to be valued at cost to the EDB, as defined by GAAP, at commissioning date. This equates to transaction value for assets purchased from a related party, for all of the transaction types outlined above.
23. If assets acquired from related parties do not meet one or more of the proposed clause 2.2.11(5) materiality thresholds or arm's length rules then they are to be subject to the provisions of proposed clause 2.2.11(1)(g). We have considered the reasonableness of each of the options proposed in clause 2.2.11(1)(g) for each of the types of related party asset transaction identified above. We have summarised this in Table Two overleaf.

Table One – Proposed 2.2.11(5) Materiality Thresholds and Arm’s Length Rules for Asset Acquisitions from Related Parties

Proposed Threshold, Rule or Information Requirement to enable assets to be valued at cost to the EDB	Type of Asset Transaction		
	i) Purchase of Assets In Use	ii) Purchase of Material Components	iii) Provision of Asset Construction Services
2.2.11(5)(a)(i) Sum of cost of all assets commissioned in year and acquired from any related party is less than 1% of opening RAB	Assessed in aggregate. Rationale for materiality threshold not provided. ENA proposed 20% of revenue. Proposed threshold unlikely to be met unless this is the only transaction type undertaken.	Assessed in aggregate. Rationale for materiality threshold not provided. ENA proposed 20% of revenue. Proposed threshold unlikely to be met for this transaction type.	Assessed in aggregate. Rationale for materiality threshold not provided. ENA proposed 20% of revenue. Proposed threshold unlikely to be met for this transaction type.
2.2.11(5)(a)(ii) Sum of cost of all assets commissioned in year and acquired from any related party is less than 20% of the aggregate cost of all assets commissioned in the year	Assessed in aggregate. Rationale for materiality threshold not provided. ENA proposed 15% of capex. Proposed threshold unlikely to be met unless this is the only transaction type undertaken.	Assessed in aggregate. Rationale for materiality threshold not provided. ENA proposed 15% of capex. Proposed threshold may be met if this is the only transaction type undertaken, depending on the quantum of materials provided. Unlikely to be met otherwise.	Assessed in aggregate. Rationale for materiality threshold not provided. ENA proposed 15% of capex. Proposed threshold unlikely to be met for this transaction type unless other credible service providers available in the EDB’s network region.
2.2.11(5)(b)(i) Directors certify that the assets acquired are provided by a related party which provides at least 75% of sales to other parties, and prices to the EDB are demonstrably the same in all material respects as those charged to other parties	Unlikely to apply to this form of transaction which is most likely to involve unique assets in discrete transactions.	Could apply to this form of transaction. Rationale for threshold not provided. ENA proposed 50% of sales, which we support as it is consistent with equality and control expectations. 75% is an extremely difficult threshold to meet, particularly for suppliers based in provincial centres with lack of access to other markets. Test is able to be applied in practice as comparable prices likely to be available for similar components.	Could apply to this form of transaction. Rationale for threshold not provided. ENA proposed 50% of sales, which we support as it is consistent with equality and control expectations. 75% is an extremely difficult threshold to meet, particularly for suppliers based in provincial centres with lack of access to other markets. We do not believe it will be met at this time. May be difficult to apply in practice as projects are priced individually.

Table One (continued) – Proposed 2.2.11(5) Materiality Thresholds and Arms Length Rules for Asset Acquisitions from Related Parties

Proposed Threshold, Rule or Information Requirement to enable assets to be valued at cost to the EDB	Type of Asset Transaction		
	i) Purchase Assets In Use	ii) Purchase of Material Components	iii) Provision of Asset Construction Services
2.2.11(5)(b)(ii) Directors certify that the price paid by the EDB is demonstrably the same or less than the price (adjusted for inflation) paid for similar assets acquired from non-related parties over the preceding three years	Unlikely to apply to this form of transaction which is most likely to involve unique assets in discrete transactions.	Could apply to this form of transaction. Dependent on access to other suppliers of similar components in order to determine comparable prices. Inflation should reflect input price inflation not CPI. Reference to relevant industry indices would be useful, and could be included in the IDRs.	Difficult to apply to this form of transaction in practice because of the range of projects/assets which are likely to be included (ie: each zone substation, line etc will have a range of unique factors which will contribute to its cost). Non-related parties are unlikely to provide a breakdown of individual cost/asset components to the EDB.
2.2.11(5)(b)(iii) Directors certify that the price paid by the EDB was determined in accordance with the lowest conforming tender received by the EDB in an open competitive tender process	Could possibly apply to this form of transaction, although an unlikely process for a unique asset transfer/transaction.	Could apply to this form of transaction. Difficulty in establishing an open competitive tender process in many network locations. ENA proposed a refined test which included the proposition that the decision to accept was made on the basis of the commercial merits of the competing bids, not simply the lowest price. We support this as the quality of the bid/components/service to be provided is relevant to the contract decision.	Could apply to this form of transaction. Difficulty in establishing an open competitive tender process in many network locations. Expect many EDBs will not be able to meet this test. ENA proposed a refined test which included the proposition that the decision to accept was made on the basis of the commercial merits of the competing bids, not simply the lowest price. We support this as the quality of the bid/components/service to be provided is relevant to the contract decision.
2.2.11(5)(b)(iv) Directors certify that sufficient documentation exists to demonstrate objectively that the price paid by the EDB is equivalent to that which would be expected under an arm's length transaction	Could apply to this form of transaction. Not clear what form of documentation the Commission expects to see.	Could apply to this form of transaction. Not clear what form of documentation the Commission expects to see. Not certain that this is an option which is achievable in practice, if (i) – (iii) above cannot be met.	Could apply to this form of transaction. Not clear what form of documentation the Commission expects to see. Not certain that this is an option which is achievable in practice, if (i) – (iii) above cannot be met.

Table Two – Proposed 2.2.11(1)(g) Provisions for Establishing the Value of Asset Acquisitions from Related Parties

Proposed Value	Type of Asset Transaction		
	i) Purchase of Assets In Use	ii) Purchase of Material Components	iii) Provision of Asset Construction Services
2.2.11 (1)(g) (i) DHC of the related party on day prior to acquisition	Reasonable option. Information expected to be available within the related party, consistent with GAAP.	Unreasonable option. Material components are held as inventory by the related party until they are supplied to the EDB who receives an invoice for them. The EDB holds them as capital WIP until the assets are commissioned. No DHC exists for the related party.	Unreasonable option. Construction services may be invoiced progressively through a contract or project. These are held as capital WIP by the EDB until the asset is commissioned. No DHC exists for the related party.
2.2.11 (1)(g) (ii) Market value at commissioning date as determined by a valuer	Reasonable option. Manageable for discrete assets.	Possible option, although there will be some compliance complexity (and hence cost) for large volumes of material components which may be commissioned at different dates. This may not be readily resolved.	Unreasonable option. Compliance complexity unlikely to be readily resolved as many different types of assets with a range of commissioning dates will be created as a result of this type of service.
2.2.11 (1)(g) (iii) Nil value	Unreasonable option however reasonable alternatives exist.	Unreasonable option however an alternative exists, albeit with a, possibly material, compliance burden.	Unreasonable option. For some EDBs it is expected that no reasonable alternative exists within the proposed approach (as outlined above). It is not appropriate for assets used to provide regulated services to be included in the RAB at nil value at commissioning date. This understates the reasonable cost of service provision and is inconsistent with the Part 4 purpose to provide incentives to invest in the infrastructure required to deliver the services demanded by consumers.

24. Accordingly, based on the analysis of each of the possible related party transaction types which may be relevant to the asset valuation IMs, we conclude that:
- a. *For acquisitions by the EDB of assets in use by the related party*, DHC or market value are appropriate valuation methods, both of which are likely to be able to be implemented in practice. Accordingly the default 'nil value' option is not expected to apply. The proposed clause 2.2.11(5) materiality thresholds will capture these types of transactions, as the thresholds are applied in aggregate. They provide a transaction cost option. In practice this is likely to reflect either DHC or market value, in any case. It is unlikely that the provisions in clause 2.2.11(5)(b) will need to be applied to these types of transaction given the suitability of the options set out in the proposed clause 2.2.11(g) (i) and (ii).
 - b. *For acquisitions by the EDB of material components supplied by a related party*, the DHC option will not apply, but the market value option is likely to apply in practice, albeit with some compliance cost and complexity regarding commissioning dates. Accordingly the default 'nil value' option could apply if this complexity is unable to be resolved. An alternative to the market value option is provided by clause 2.2.11(5) if one or more of the materiality thresholds or arm's length rules can be met, ie: the assets can be included at transaction cost. We believe the materiality thresholds are unlikely to ever be met where related parties also supply asset construction services. We support the ENA's proposed thresholds for this reason. The clause 2.2.11(5)(b) director certification options have a number of practical difficulties for this type of transaction, as outlined above.
 - c. *For acquisitions by the EDB of construction services provided by a related party*, we believe that neither DHC nor market value will be practical options for many EDBs. Accordingly the default 'nil value' will apply unless one or more of the clause 2.2.11(5) materiality thresholds or arm's length rules can be met. We believe the materiality thresholds are unlikely to apply in most instances where related parties supply asset construction services to the EDB, because of the lack of viable alternative service providers in many locations in New Zealand. These characteristics also mean the tests in clause 2.2.11(5)(b) which require director certification are also unlikely to be met in some circumstances. If this is the outcome, the current proposal is that assets will be included at nil value.
25. Whilst we recognise that the inclusion of the 'cost to the EDB' option is an improvement on the current IM, we do not believe the inclusion of the 'nil value' option is consistent with Part 4. The Part 4 Purpose Statement includes the requirement for regulation under Part 4 to provide sufficient incentives for regulated suppliers to invest in the infrastructure required to provide the regulated service consistent with consumer demands. The lack of access to external providers for asset or capital related services should not be viewed as a failure on the part of the EDB to act responsibly. The ENA's IDR submission set out in some detail the rationale for the ongoing reliance of EDBs on related parties in providing a number of electricity distribution services.⁶
26. The draft IMs include potential penalties (ie: commissioned assets acquired from related parties are included at nil value under some circumstances) which is inconsistent with any potential detriment. It is likely that some EDBs will be unable to recover any of the capital related costs where services are provided by related parties, simply because of the lack of viable alternatives or evidence consistent with the Commission's expectations. The proposal also discriminates between those EDBs which have structured their businesses into subsidiary or other separate commercial arrangements, when compared to those which have retained those services within the EDB. Under no circumstances are EDBs which undertake their asset construction services in-house required to include commissioned assets at nil value.⁷
27. Accordingly we do not support the proposal that the default option is 'nil value'. We do not accept the Commission's rationale that the nil value option is a deterrent designed to ensure EDBs meet one or the other thresholds or rules or apply one of the other options. This is not consistent with the Part 4 purpose t

⁶ Supra n5 paragraphs 122 - 126

⁷ For the purpose of this discussion we have ignored the impact of capital contributions and vested assets which are to be treated the same under all scenarios.

incentives investment, if the alternatives are not able to be applied in practice, and the thresholds unable to be met by virtue of the characteristics of the market.

28. We refer to the NERA Paper submitted by the ENA which highlights *“the potential to discourage efficient outsourcing and to penalise conduct that is consistent with workably competitive market outcomes”*⁸ in response to the Commission’s proposed approach to related party transactions for IDR. The nil value default implies that those which purchase asset construction services from related parties, and are unable to meet the 2.2.11(5) thresholds and tests, must either source market values for these services (which we envisage is not practical in or circumstances) or value them at nil value.
29. Accordingly we submit that as a minimum the default option should be the directly incurred cost to the related party. This can be defined as the costs incurred by the Group to which the EDB and related party belong, by applying GAAP (ie: it eliminates any margin included in the transaction cost over and above direct cost). This would ensure that those EDBs which have adopted commercial structures by establishing their construction related services as a subsidiary or separate commercial entity are treated at least the same as those which have maintained these services within the EDB. To do otherwise would penalise the former arrangement (by ascribing nil value to assets constructed by a related party) relative to the latter arrangement (by ascribing cost to assets constructed by the EDB).
30. This is also consistent with the efficiency incentive objectives of the Part 4 Purpose Statement as it incentivises, by offering the higher transaction cost alternative, should the arm’s length principles be able to be met.

Other Practical Considerations

31. Clause 2.2.11 is drafted as if the methodology is applied at an individual asset level. EDBs have hundreds of thousands of individual assets. The proposed processes, particularly those set out in clauses 2.2.11(1)(g) and 2.2.11(5) are not practical to apply at an individual asset level. GAAP permits aggregation of assets which have similar function, and for example in relation to depreciation, similar useful lives. It would be reasonable for similar principles to apply in respect of clause 2.2.11. Related party transactions which involve assets are likely to involve many assets within a single transaction; a number of transactions for a project; and many transactions or projects within a contract. When applying the market valuation, materiality thresholds and director certification options it is reasonable for the requirements to be applied on a contract, project or transaction basis if these are more practical and relevant to the method being applied, than on an individual asset basis. We agree that the form of the Director’s certification can be specified in the IDRs, however the IM should not suggest that the directors must certify for “an asset”.
32. In addition, the requirement for market values at commissioning date of each asset is overly burdensome. The commissioning date has very little impact on the RAB compared to the commissioning year. Depreciation does not apply until the year following the commissioning year, and the only measure which in principle relies on commissioning date is “RAB proportionate investment”. For IDR, current consultation suggests a more pragmatic approach by weighting commissioned assets across the year. For CPP it is not clear how a market valuation approach could be applied to forecast capex (refer below). Accordingly we suggest it is acceptable to obtain market valuations of assets within their commissioning year for IDR purposes. This will allow like assets to be grouped together where they are commissioned in the same year for valuation purposes.
33. The CPP asset valuation IM is forward looking. The Consultation Paper does not explain how the proposed thresholds and rules can be applied in practice to forecast capex. If they are not able to be applied, then the current drafting suggests that any relevant capex which is forecast to be acquired from related parties will be included at nil value. This cannot be consistent with the intent of a CPP (for example Schedule D17 in the CPP IM includes specific information requirements pertaining to related party transactions). We suggest the Commission consults further on its intended approach to the CPP IMs in this respect. We note that the Commission has an explicit role to assess the reasonableness of a CPP proposal, including how an

⁸ NERA Economic Consultants, Treatment of Related Party Transactions, 9 March 2012

EDB proposes to execute its planned opex and capex programme. The asset valuation IM should not predetermine an outcome with respect to the involvement of related parties in this respect.

34. The Consultation Paper does not indicate how the amended IM is to be implemented in practice. In this respect we note that it would not be reasonable to apply the amended IM retrospectively where it requires departures from GAAP in relation to the value of asset additions. EDBs have been recording additions at cost (consistent with GAAP) for the RAB since the 2008 IDRs were implemented. When these were implemented they were applied retrospectively as far back as 1 April 2004. This was possible because the information required had already been prepared for financial reporting purposes. It is unreasonable for EDBs to be required to retrospectively establish market values for assets commissioned in previous disclosure periods, and for the thresholds and rules to be applied retrospectively to disclosure periods where they did not exist and EDBs did not have the opportunity to make purchasing decisions or compile relevant evidence on the basis of those thresholds or rules.

Summary

35. In summary we submit that:

- The EDBs which are represented by this submission support consideration of alternative options for valuing related party transactions for the purpose of establishing the RAB
- We also support reliance on GAAP where possible, because this assists to minimised compliance costs and is well understood by users of financial and regulatory information
- Our view is that related party transactions should be included at transaction cost, consistent with GAAP, and sufficient information made available to interested persons to establish how this cost has been determined (as previously submitted in response to the January 2012 ID consultation)
- Without prejudice to this view we consider the proposal to allow assets acquired from related parties to be included at cost to the EDB under certain circumstances to be an improvement on the current IM
- We have included suggested modifications to the proposed materiality thresholds and arm's length rules which must be met before cost to the EDB can be applied. These are consistent with our earlier ID submission, and are a more reasonable reflection of the market characteristics for asset construction services for EDBs in New Zealand
- The Consultation Paper does not fully consider the different types of asset related transactions which may occur between an EDB and related parties. These are likely to include the purchase of assets in use, material components and asset construction services. Some of the options proposed, such as DHC or market valuation, are not practical for all of these types of transactions
- Accordingly, unless an EDB is able to meet the materiality thresholds or arm's length rules, the default 'nil value' option is likely to apply to some types of transaction. We do not believe this outcome is consistent with the Part 4 Purpose Statement which requires that the regulation imposed under Part 4 must provide incentives to invest in the infrastructure required to provide the regulated service. Impairing assets to nil value on commissioning is not consistent with this.
- In addition the 'nil value' default option discriminates against those with related party arrangements for asset related services when compared to those which have retained these services in-house
- The default option should therefore be specified as 'directly attributable cost' which is consistent with the cost to the group to which the related party and EDB belong, in accordance with GAAP. This outcome is consistent with the Part 4 Purpose and includes incentives to achieve the transaction value outcome should arm's length principles be able to be adequately justified

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- The proposed IM amendments must recognise that the thresholds, rules and valuation options cannot in practice be applied at an asset level. Transactions, contracts or groups of like assets are more appropriate than each individual asset
 - The proposed changes to the CPP asset valuation IM have not been provided. They should not predetermine an outcome by applying the same thresholds and rules as are proposed for ID, which are able to be applied with the benefit of hindsight. The CPP is a proposal and therefore should include related party transactions at cost, DHC or market value as preferred by the EDB for the purpose of that proposal. The CPP IM already sets out requirements for the EDB to justify its approach in this respect
 - The proposed amendments to the IMs should not be applied retrospectively.