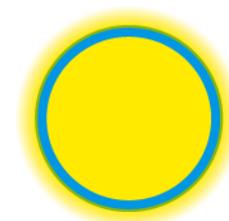


29 May 2012

Karen Murray
Manager
Regulation Branch
Commerce Commission
P O Box 2351
Wellington 6140

[Sent by email to: regulation.branch@comcom.govt.nz]



Dear Karen

Powerco submission on Input Methodology Determination Amendments

Introduction

1. Powerco Limited (Powerco) welcomes the opportunity to comment on the Consultation Paper: *Consultation on Electricity and Gas Input Methodology Determination Amendments 2012* (Consultation Paper), published by the Commerce Commission (Commission) on 17 April 2012. As an Electricity Distributor Business (EDB) and Gas Pipeline Business (GPB), we are impacted by both proposed amendments.
2. Powerco has reviewed and supports the comments made by the Electricity Network Association in its submission on the Consultation Paper.

Treatment of related party asset acquisitions

3. The value to be assigned to assets which are acquired from related parties when determining the regulatory asset base (RAB) was discussed when the IMs were determined in December 2010, and subsequently as part of the Draft Information Disclosure Determination consultation. As a result of the IM development in 2010, an approach supported by the industry, consistent with generally accepted accounting practice (GAAP) was introduced. This method minimised compliance costs as information can be taken from financial reporting systems. GAAP also provides rules which are well understood by accountants and auditors.
4. Therefore we believe that the Commerce Commission (Commission) must provide clear justification and evidence to the benefits of amending the methodology, which was favoured and considered appropriate in meeting the purpose of Part 4 of the Commerce Act less than 18 months ago before any amendments occur. Currently this has not been demonstrated fully in the Paper.

Default Option

5. The Commission has proposed that assets acquired from related parties be included in the RAB at:
 - transaction value where materiality thresholds are met, or where there is evidence the costs reflect arms length prices, was tendered or outsourced; or
 - DHC to the related party, providing sufficient records exist; or
 - market value as determined by a valuer; or
 - nil value (the default option).
6. Powerco recommends that the default option should be 'directly attributable cost', rather than 'nil value'. There are valid reasons for an EDB to have related parties provide services to the EDB. The default option potentially penalises EDBs who are unable to meet the proposed materiality thresholds or other criteria, for example, if there is no active market to provide the necessary evidence. The Commission must fully consider if the proposal is workable.
7. Using 'directly attributable cost' has the benefit of being defined in GAAP and on consolidation, related party margins for services supplied to the EDB are eliminated under GAAP. This will ensure that those with related party arrangements are not penalised in comparison to those with in-house arrangements.

Inconsistent criteria

8. The criteria set out in the draft IM differ from those proposed in the draft IDRs. As the Consultation Paper does not explain how its criteria were developed, it is difficult to comment on the targets which are included in the criteria.

Application to CPPs

9. Customised Price Path (CPP) proposals are forward looking. It may be difficult to apply some of the methods in the IM on a forward looking basis. Powerco recommends that for CPP proposals, the value of additions should be included at the cost to the EDB. The Commission is then able to assess this cost as part of its final Determination.

Drafting improvements

10. If the Commission continues with the proposed amendment, Powerco would expect drafting improvements, as we have had to make assumptions on the intention in some areas of the consultation paper.
11. Clarification is required on why the list set out in the *Amendments* section of the Paper on pages six and seven is split out between sub-clause (1)(g) and sub-clause (5). All of the list applies to assets acquired from related parties. This seems to contradict the intention of the list in the amendments in the Paper, which we are reading as intending to offer an EDB an exhaustive list of valuation methods where the asset acquired is from a related party.
12. If the valuation methods for all and any assets acquired by related parties are set out in one exhaustive list in sub-clause (1), it would be simpler and clearer. However, we recognise

that we may be misinterpreting the point and it may be that sub-clauses (2)(3) and (4) are not intended to apply to the assets in (5) regarding the GAAP method of calculating the cost of financing for some of the assets. If this is the case we believe it should be made clearer.

13. If sub-clause (5) is to remain where it is, there are a number of drafting suggestions to make this clause clearer. Importantly, sub-clauses (5)(b)(i) and (ii) should have the word 'or' included at the end as the list here is an either/or scenario. You would not have a directors' certificate certifying that an asset fell under both (i) and (ii), as they cover different scenarios.
14. It is also not clear from the drafting whether the valuation methods listed in new sub-clause (5) will use GAAP to calculate the transaction value. While this is implied from the opening wording of clause 2.2.11(1) it is not clearly stated. Clause 2.2.11(1) refers to the use of GAAP to calculate the cost of an asset on its commissioning date and the exceptions listed out in the sub-clauses that follow would, necessarily, also use the GAAP accounting method. Rather than rely on implied meanings we believe it would be clearer to be explicit about whether the accounting method to apply was or wasn't GAAP.
15. An additional drafting recommendation is that 'or' should be included in 2.2.11(1)(g)(i). This sub-clause contains a list of various methods of calculating the value of an asset acquired from a related party which are to conform with the suggestions set out in the amendments section of the Paper on pages six and seven. The use of 'or' ensures only one of the methods in the list needs to be applied to the asset in question.

Disclosure year for gas pipeline services

16. Powerco welcomes the Commission consulting on the definition of the disclosure year in the IM's and supports the Commission's preferred proposal of a single common disclosure year from 1 October to 30 September. Like the Commission, we recognise aligning regulatory reporting year with other key periods provides benefits by removing complexity and compliance costs. This has recently led us to change our financial year balance date from 30 June to 31 March to align with the electricity distribution business (EDB) regulatory reporting period.
17. The Commission's previous consultation work on gas distribution services information disclosure¹ and the gas distribution default price-quality path (DPP) determination² has resulted in the period of 1 October to 30 September being the preferred period for DPP compliance and information disclosure. We believe that for consistency it is logical for the IM's to align with these.
18. Powerco has recently sought to achieve efficiency savings by aligning our financial year with the EDB regulatory reporting period. While this creates many benefits, it requires Powerco to complete financial year end reporting and EDB regulatory reporting concurrently. If gas disclosure reporting was also aligned to the financial year it could negatively impact on the benefits gained by the recent changing of Powerco's financial year by adding additional work during an already busy period for both ourselves and our external audit team. Powerco considered gas disclosure reporting when evaluating the change to

¹ Information Disclosure Regulation Electricity Lines Services and Gas Pipeline Services Process

² Gas Pipeline Services Process and Issues Paper and Discussion Paper, 1 April 2011.

our financial year, and concluded that the six month period between the new financial year and the proposed disclosure year aligned well with our six month financial reporting requirements.

19. Powerco supports the Commission's preferred implementation proposal and believe that it provides the best solution. Work would be required to roll forward our RAB figures from the 1 July 2009 to the 30 September 2009 but as we are already required to do this under the draft information disclosure determination 2012 we see it as an acceptable consequence to creating a common disclosure year.
20. We have reviewed the proposed changes to the draft input methodologies for GDBs and are satisfied that they reflect the Commission's proposed preferred options and require no further amendments.
21. Thank you for the opportunity to make this submission. If the Commission wishes to discuss any aspects further, please do not hesitate in contacting me on 06 757 3397 or oliver.vincent@powerco.co.nz.

Yours sincerely,

A handwritten signature in blue ink that reads "Oliver Vincent". The signature is written in a cursive style with a long horizontal stroke extending to the right.

Oliver Vincent
Regulatory Analyst
Powerco