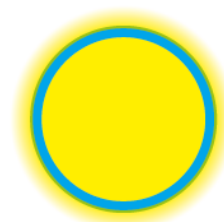


4 October 2017

Keston Ruxton
Manager, EAD Regulation Development
Commerce Commission,
PO Box 2351,
Wellington 6140.

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



Dear Keston

Powerco Cross Submission to the Related Party Transactions draft decision determinations and guidance

Introduction

1. Powerco Limited (Powerco) welcomes the opportunity to provide feedback on the views submitted in relation to on the Commerce Commission's (Commission's) consultation paper, *Input methodologies review draft decision related party transactions draft decision and determinations guidance* (the guidance paper) and associated draft Determinations.
2. The short period for cross-submissions means we have focused our submission on four key issues that underpin the related party regime:
 - The definition of related party
 - valuing related party transactions
 - Compliance requirements are proportionate to the problem they are addressing
 - Level of assurance required
3. Powerco remains supportive of the Commission's proposal to
 - move to a principles-based approach for related party transactions
 - support this with proportional disclosure requirements and assurance under standard auditing rules.
4. Linking the related party regime to accounting and auditing standards should lower the complexity and confusion for suppliers and their auditors. In addition, interested parties will be able to readily understand the concept of related party transactions (RPTs) and be assured the principles have been applied appropriately.
5. Our comments should be considered in light of these guiding statements.

Definition of related party

6. The Commission has highlighted that the complexity of terminology and ambiguity in key defined terms contribute to the problems with the current related party provisions.¹ The adoption of the principles-based approach to valuation is intended to resolve this.
7. We share the concern of other submitters that the revised definition of a related party has created more confusion. The proposed related party definition² includes two limbs—
 - a) A person that is related to the EDB where the EDB is considered as the ‘reporting entity’ as specified in the definition of ‘related party’ in NZ IAS24
 - b) Any part, branch or division of the EDB that does not supply electricity distribution services.
8. The aspect requiring further consideration is limb (b). The first limb, (a), aligns to accounting standards and is easily understood and applied. However, many submitters have noted that it is difficult to determine the extent to which the limb (b) applies. We echo their concerns that this limb may be applied inconsistently. If so, the outcome will be inadvertently adding unnecessary compliance costs.
9. Submissions include numerous examples of the confusion. For example ERANZ consider *the lack of clarity of the [related party] definition has been highlighted by some questioning whether internal legal advice would be regarded as being provided by a related party*³. At the same time PwC suggest the Commission have potentially captured such internal divisions in clause 4.48 of the guidance paper but this is not a related party transaction.
10. Further, the addition of the limb (b) is confusing to interpret in light of the cost allocation Input Methodology (IM). We agree with Westpower and Marlborough Lines that the worked examples provided in the guidance paper do not explain why transactions are considered a related party. For instance, example 2⁴ in Attachment A describes transactions between Regional Lines and one of its divisions, Regional Lines Engineering. It is not explained in the example why the related party transaction rules are applied in preference to applying the cost allocation IM.
11. We agree with the PwC submission that transactions involving a division of the regulated business should not be captured by the related party provisions.⁵ This can be managed through application of the cost allocation IM.

Valuing related party transactions

12. The draft guidelines paper proposes the value of a related party transaction is to be no more than arm’s-length. The determination of arm’s-length value is based on objective and independent measures, subject to auditor scrutiny, and requires director certification.
13. Powerco agrees with other submitters that the adoption of a principles-based approach to assessing and valuing transaction should be much easier to apply than the mix of valuation measures currently held in the IMs and Information Disclosure Determinations.

¹Commerce Commission Input Methodologies review decision – draft decision and determinations guidance – 30 August 2017 (tables 3.1 and 3.2)

²Comments refer equally to GPBs and the reference to EDBs only is for ease of example.

³ERANZ submission: related party transactions draft decision (page 3).

⁴Commerce Commission Input Methodologies review draft decision related party transactions and determinations guidance, 30 August 2017 (page 71).

⁵PwC submission to the Commerce Commission on Input methodologies review draft decision on related party transactions. Paragraph 24 (page 6).

14. As Unison notes, determining the arm's length value sufficient to satisfy auditors may be difficult and add unnecessary compliance cost. We support their view that the *Commission should provide guidance that EDBs may demonstrate compliance with the valuation rules in a manner that is proportionate and cost effective....and provide further examples of the methods acceptable to validate related party prices.*⁶
15. In Powerco's submission to the draft guidance and determinations, we suggested that the Commission host a work shop for auditors and suppliers. This will ensure that we all have the same understanding of the requirements and further develop the guidance paper and examples. Unison supports this concept⁷ and suggested it be extended to include valuers. The addition of valuers will assist in developing pragmatic solutions for obtaining suitable objective and independent values to transactions.

Proportionality of disclosure requirements

16. PwC submitted that cost effective compliance requirements must be proportionate to the problem they are trying to solve. We support the recommendations in paragraph 42 of the PwC submission. We agree that disclosure requirements that don't address the arm's-length nature of related party transactions should be removed from the related party transactions. This will remove unnecessary cost while still meeting the policy intent.
17. We further recommend the Commission consider the benefits of a de-minimis threshold proposed by both Vector and Powerco. Implementing some of the information disclosure requirements, including regular testing of the market, may mean costs outweigh the benefits for consumers when the related party transactions have a small nominal value.

18.

Level of assurance required

19. The Commission has supported their proposed principles-based approach with increased scrutiny by auditors. To facilitate this, the rules are tied to accounting standard NZ IAS 24 and a further auditing standard ISA (NZ) 550.
20. We appreciate the effort the PwC auditors have made to review the proposed changes to the IM Determination and Information Disclosure Determinations⁸. We support the inclusion of their proposed changes into the appropriate Determinations and guidance paper. It is important for all stakeholders that auditors are able to opine on the information provided.
21. We agree with the PwC auditors that the requirement to audit any material in the asset management plans (AMP) will add costs to the suppliers as our AMPs are currently not subject to external audit. We support
22. We agree with other submitters that it is difficult to see the benefit of the extra assurance report. Auditors will be required to form an opinion on whether the related party transactions meet the general valuation rule. The extra assurance report does not appear to provide any extra assurance above that given by the auditors, and by the additional Director certification.
23. The independent appraiser will be providing assurance over the same information as the auditor. It is difficult to see how they would come to a different conclusion. Therefore we recommend that the requirement for an independent assurance report be removed.

⁶ Unison Networks Limited – input methodologies review: related party transactions – submission on draft decision, 27 September 2017, (Page 3)

⁷ Unison submission, point (g) (page 5)

⁸ PwC Auditors submission – Input methodologies review: Related party transactions – submission on draft decision, 27 September 2017.

24. We are of the same opinion as Unison⁹. In circumstances where our auditors are unable to form an opinion then it will be necessary for us to obtain further evidence to support, or otherwise determine the transaction values. We would expect to obtain additional expert reports and would do so as part of the audit process to ensure matters are resolved before disclosures are finalised and prior to certification by Directors.

Timing of amendments

25. It is proposed that the new definition for related parties and associated disclosure requirements will take effect from 1 April 2018 for our electricity distribution business and from 1 October 2018 for our gas distribution business. This may be difficult to achieve depending on the final determination of the related party definition, valuation evidence, and level of disclosure required.

26. We support the recommendations of other suppliers that it may be useful to defer the effective date of the proposed changes. This provides time to complete the tasks required to move from cost-based methods to the principles-based approach.

Contact for submission

Thank you for the opportunity to provide comments on this consultation. If you wish to discuss any of the points made, or clarify any matters, in the first instance please contact Lynette Taylor tel. (06)968 6235, email lyn.taylor@powerco.co.nz.

Yours sincerely



Richard Fletcher
General Manager Commercial and Regulatory

⁹ Unison Networks Limited – input methodologies review: related party transactions –submission on draft decision, 27 September 2017, (Page 5)