

27 September 2017

Manager, EAD Regulation Development  
Regulation Branch  
Commerce Commission  
PO Box 2351  
**WELLINGTON**

**ATTENTION:** Keston Ruxton

**By email to:** [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)

Dear Keston

## **Submission to the Commerce Commission on related party transactions**

### **Draft decision and determinations guidance – 30 August 2017**

#### **Our Submission**

1. We appreciate the opportunity to comment on the Commission's paper on this matter and also engage with the Commission during this process.
2. We generally support the views expressed in the submission made by the ENA on the Input Methodology relating to related party transactions. We are also generally support the submission made by PricewaterhouseCoopers (PWC) on the same matter which is made on behalf of 17 EDB, of which we are a party.
3. In addition to the views expressed in the ENA and PWC submissions referred to above we wish to express views on a number of points that are further relevant for Marlborough Lines (MLL).
4. This submission sets out our particular views on:
  - a. The second limb of the Related Party definition that incorporates a branch or a division of the regulated business; and
  - b. Associated compliance costs with the draft decision.

### **Marlborough Lines activities and interest in this matter**

5. MLL is 100% owned by the Marlborough Electric Power Trust (MEPT) and the ultimate beneficiaries of our business are the electricity consumers in Marlborough.
6. MLL has its own in-house contracting division that completes most of the maintenance, vegetation management and replacement upgrades on our network on a cost basis, although we utilise external resources as necessary to manage the peak workload. Examples of the use of external resources this past year include:
  - Following the November 2016 earthquake we brought in a number of crews from neighbouring electricity distribution businesses to assist with earthquake repairs;
  - In May 2017 we had a major line re-build project between Tuamarina and Picton. We contracted resources from neighbouring distribution businesses to assist with general work; and
  - On a regular basis we contract vegetation companies to complete work on our network to take the peak off heavy workload.
7. MLL believes maintaining its own Contracting division enables it to maintain the resources it requires to manage and retain key staff, maintain standards and quality of workmanship, and also avoid being captured by an external provider. The company believes an internal contracting division is in the long term interests of consumers.

### **Definition of a Related Party**

8. While we appreciate the efforts that the Commission has taken to provide examples and diagrams of how to interpret the definition of a Related Party, upon reading of the draft decision we are unclear as to whether our contracting division, or any of our other divisions falls within this definition and whether should be treated as a Related Party.
9. The draft decision (IM clause 1.1.4(2)) defines a Related Party as:
  - *a) a person that is related to the regulated business, where the regulated business is considered the 'reporting entity', as specified in the definition of 'related party' in NZ IAS 24; or*
  - *b) any part; branch or division of the regulated business that does not supply regulated services.*
10. Section 54C of the Commerce Act 1986 defines the regulated service of electricity lines services as *'the conveyance of electricity by line in New Zealand.'*
11. An example provided in Table 4.4 of the draft decision provides further guidance in how to interpret the second limb of the Related Party definition as follows:

- *‘Detail: As we regulate the service and not the legal entity, any part of the entity that operates the regulated service, but which does not supply the regulated service, is considered a related party.’*
  - *‘Example/s: 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.’*
12. Attachment A of the draft decision then provides a worked example of a regional lines division situation that operates a Regional Lines Engineering division. There is no information provided on how the Engineering division has been deemed to be a Related Party, however it is defined as such.
  13. Upon interpreting the provided examples, it would appear that the Marlborough Lines Contracting division does fall within the definition of Related Party and therefore should be treated as such. However, verbal advice provided by the Commission indicated to us that our contracting division would fall within the definition of electricity lines services and therefore fall outside the definition.
  14. This is a confusing situation and appears to come down to subjective assessments about whether a part or division of the entity operates the electricity lines service or supplies the regulated service.
  15. For example, does the Engineering division of Marlborough Lines (which only does work for Marlborough Lines) operate the regulated service of conveying electricity by line? Does the same Engineering division supply the service of conveying electricity by line?
  16. MLL would like some specific assistance about how to interpret this definition as it is unworkable in practice as currently drafted. If interpreted tightly, it would seem that only the electrical assets, and perhaps only a subsection of those (i.e. arguably a pole doesn’t convey electricity, but conductor does) meet the definition of supplying the service of conveying electricity by line.
  17. Common sense would suggest that the costs that an EDB incurs in employing its own staff to run its business of keeping the assets maintained and the lights on, including all the support services, should be dealt with under cost allocation requirements, rather than related party requirements.
  18. To give the Commission some more insight, MLL conducts our business like we believe many others do, based on project workorders. Time and costs are coded to these workorders to determine the cost of the project, whether it be an operating

expenditure/maintenance project or a capital expenditure project. An example of how this may work is as follows:

<b>Type</b>	<b>Division</b>	<b>Nature of cost</b>	<b>Cost basis</b>
Internal	Engineering	Project planning and design	Time applied at cost rate
External - Lawyer	n/a	Legal costs in obtaining consent and line route	External charges
External - Equipment	n/a	Purchase of poles and conductor	External charges
Internal	Stores	Procuring and holding poles and conductor	Cost recovery
Internal	Electrical Contracting	Labour, vehicles and equipment to construct line	Time, vehicles and equipment applied at cost rate
External – contracting	n/a	Labour, vehicles and equipment to construct line	External charges, competitively tendered
Internal	Vegetation Contracting	Labour, vehicles and equipment to clear line of vegetation	Time, vehicles and equipment applied at cost rate
External – civil works	n/a	Line construction, trenches etc	External charges, competitively tendered
External – traffic management	n/a	Management of traffic around work site	External charges
Internal	Asset Management	Entering as-build information into GIS and asset management system	Time applied at cost rate

19. Per the example above, five divisions from MLL may have been involved in various stages of the one project being Engineering, Stores, Electrical Contracting, Vegetation Contracting and Asset Management. Each of these divisions has coded cost to the Project so that the constructed assets represent the actual costs of construction.

### **Compliance costs**

20. We are hopeful that either the definition of a Related Party, or the guidance of how to interpret the related party definition is improved so that none of MLLs divisions are caught by this definition. If for some reason it is determined that these should be included then we have real concerns about the costs of complying with this new regulation.

21. From our point of view this increased complexity would either require a significant change to our finance systems or significant time and effort meticulously combining through each one of our many hundred work orders per year, trying to split out internal and external costs. We would then be required to prove that these transactions were valued on an arm's-length basis and then any such information disclosed would be required to be audited.
22. It is obvious that the compliance costs of this would be significant and we cannot see any obvious benefit to our consumers of this regulation. Marlborough Lines has determined that it is most efficient to have an in-house contracting division (along with in-house engineering, asset management, and finance teams), as it allows us to manage staff health and safety, work quality and staff engagement. If we were to outsource these functions then the external party would have a profit margin and we would expect to pay higher costs. We don't believe that the drivers on an external party to operate an efficient business are any different to the drivers that we face in trying to operate an efficient business to greatest benefit to our beneficiaries, the consumers of Marlborough.

### **Conclusion**

23. The Related party transaction draft decision includes a seriously flawed definition of a Related Party, that could have un-intended consequences and unnecessarily require EDBs to incur significant compliance costs.
24. We submit that part (b) of the Related Party definition be removed and the Commission revert to a definition that would line up with the accounting standards definition of a Related Party, which requires a separate legal entity.

Yours sincerely



Gareth Jones  
**Chief Financial Officer**