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WELLINGTON

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Dear Keston

Input methodologies review – Related party transactions Invitation to contribute to problem definition

Genesis Energy Limited welcomes the opportunity to contribute to the Commerce Commission's ("the Commission") problem definition regarding related party transactions, dated 12 April 2017 ("the Paper").

As noted by the Commission, a supplier of a regulated service under Part 4 of the Commerce Act 1986 ("Part 4") has market power and, absent regulation, can be expected to exercise that market power. When regulating the regulated service, the Commission assumes the costs that regulated suppliers incur reflect efficient costs. This may not always be the case yet it is difficult for interested persons to assess as insufficient information is currently disclosed. Therefore, we welcome the Commission's review of related party transactions as part of the wider input methodologies review.

We note that the Commission's "*policy intent is to ensure:*

- i) related party transactions are treated and expressed in a way that is akin to transactions made at arm's length values and terms; and*
- ii) where a regulated supplier transacts with a related party, the value of the transaction should therefore be based on a demonstrated objective and independent measure, which may differ from the actual purchase price."*¹

The success of this, as with any policy intent, can only be measured if relevant information is publicly disclosed allowing for monitoring, and assessment, by interested persons. We agree that useful changes could be made to both the design and

¹ Paragraph 2.54, page 18 of the Paper.

implementation, as well as the application, of the related party transactions regime to facilitate this. We support the focus areas identified by the Commission, namely:

- a) Consideration of imperfect local market in contracting services;
- b) Complexity of terminology and the understanding of such terminology;
- c) Transparency of the Commission's methodology and the valuation of transactions; and
- d) Compliance and disclosure requirements.

Transparency and monitoring

We are particularly concerned there is insufficient transparency surrounding related party transactions. For example, we believe there should be disclosure of the procurement process where a related party transaction is used to deliver a good or service by an Electricity Distribution Business's ("EDB") so allowing interested persons to assess whether it is akin to an arm's length transaction and the purpose of Part 4 is being met.

While we are of the view that greater transparency would benefit all types of transactions (for example, tree maintenance), these issues will become more significant in the future. We see a departure from the traditional expenditure on poles and wires, in both the building of the network and dealing with demand response services, with EDBs instead looking to procure technology solutions to deliver the regulated service. We would be concerned if these solutions were procured, by default, through related party transactions.

For example, if an EDB has an actual or potential constraint on the network this should be publicly disclosed so providing the competitive market an opportunity to offer a solution (for example batteries, demand management or distributed generation) rather than an EDB favouring a solution provided by a related party without first notifying the market. We understand there may need to be a materiality threshold for reasons of practicality.

Further, greater granularity and transparency of an EDB's procurement process, including the disclosure of compartmentalised or disaggregated information, rather than aggregated information, would shine light on related party transactions. Disclosure of EDBs' procurement processes, decision making and evaluation of related party transactions, as well as disclosure of circumstances where they are looking to engage a related party e.g. to procure a good or service to address a network constraint, would be beneficial. This would allow the Commission, supported by the market, to better evaluate the efficiency of these transactions resulting in better outcomes (i.e. costs in line with a contestable market) for the regulated consumer.

We look forward to the publication of the Commission's draft decision and the opportunity to comment on the detailed solutions to the issues raised in this Paper.

Finally, we have read the Electricity Retailers' Association of New Zealand's submission and support it.

If you would like to discuss any of these matters further, please contact me on 04 495 3348.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Rebekah Cain', with a long horizontal flourish extending to the right.

Rebekah Cain
Manager, Government Relations and Regulatory Counsel