

17 May 2017



Keston Ruxton
Manager, Regulation Development
Regulation Branch
Commerce Commission
By email: regulation.branch@comcom.govt.nz

Wellington Electricity
Lines Limited
85 The Esplanade
Petone, PO Box 31049
Lower Hutt 5040
New Zealand
Tel: +64 4 915 6100
Fax: +64 4 915 6130
www.wellington-electricity.co.nz

Dear Keston Ruxton

INPUT METHODOLOGIES REVIEW: RELATED PARTY TRANSACTIONS PROBLEM DEFINITION

Wellington Electricity Lines Limited (**WELL**) welcomes the opportunity to respond to the Commerce Commission's (**Commission**) problem definition regarding the related party transactions framework.

WELL supports the policy intent of the related party transactions framework (i.e. ensuring transactions between related parties and suppliers of regulated services are akin to arms-length terms and values). WELL considers that with the exception of some improvement to the design and structure of the related party rules, the existing provisions in the input methodologies and information disclosure requirements are working effectively to support this policy.

WELL is concerned that the quantum of related party transactions and the Commission's perception of the problem is overstated. WELL considers the efficiency and fair value of these transactions, rather than the total quantum, should be the driver of any further changes.

WELL does not consider that material amendments to the existing framework are required.

More specifically, WELL supports the following:

- the use of Director certification to demonstrate the efficiency of related party transactions remains an appropriate and strong basis for evidencing this; and
- aligning definitions between operating and capital expenditure regarding related party transactions to help clarify the rules and avoid any interpretation issues.

Our submission discusses these two issues in further detail.

1. Director certification

The Commission appears to suggest there is an over-reliance on the use of Directors Certification for confirming related party transactions reflect arms-length terms and values, and that this is somehow a 'soft' option. The existing provisions in the input methodologies and information disclosure requirements provide a range of options for electricity distribution businesses (**EDBs**) to use when determining the value of related party transactions. WELL supports the flexibility inherent with multiple valuation options (reflecting the different circumstances that exist within the sector). A range of factors need to be considered when evaluating the most appropriate valuation option for an EDB. For example, it is not practical to run a tender process with external parties solely so an EDB can demonstrate its related party transactions are arms-length.

WELL has previously used Director certification to demonstrate that related party transactions are at arms-length terms and for the reasons noted below considers that Director certification is a robust and practical valuation option for related party transactions.

To provide certification, Directors require evidence that related party transactions are at arms-length and there are strong incentives on Directors (penalties and other punitive measures) for ensuring they have sufficient evidence when making such representations.¹ The rigour and discipline this demands of EDB's to demonstrate why related party transactions are at arms-length should not be underestimated.

Director certification is also supported by the incentive framework. The regulatory framework (e.g. the incremental rolling incentive scheme) provides EDBs with strong incentives to minimise expenditure. This includes structuring related party transactions to only incur efficient costs.

In addition, there are other good principles and practices that provide strong guidance to EDB's on how to value related party transactions. This includes the existing tax transfer pricing rules which require Companies to document how and why cross-border related party transactions are at arms-length.

Given the above, any changes to the related party transaction framework regarding Director certification should be limited to improving transparency, subject to respecting commercial confidentiality (although, for clarity, WELL does not consider such changes are necessary).

2. Alignment of definitions

WELL supports the alignment of definitions and valuation options across the input methodologies and information disclosure requirements to avoid the risk of misinterpretation or inconsistent application. As set out in the submission by the Electricity Networks Association, consistency between the treatment of operating and capital expenditure (in regard to sequencing, terminology and criteria) should be the primary objective of the Commission's review.

Where practicable, WELL has a strong preference for administrative simplicity that minimises regulatory burden.

3. Conclusion

For the reasons stated above, WELL cautions the Commission against over-stating problems with the existing related party transaction framework. There already exist strong mechanisms and incentives for ensuring related party transactions are valued in a manner consistent with third party arms-length transactions. Ultimately, changes to the existing framework that increase regulatory burden will expose customers to higher prices.

If the Commission has any queries regarding WELL's submission, please do not hesitate to contact Jeff Anderson, Regulatory Projects Manager, at janderson@welectricity.co.nz.

Yours sincerely



Greg Skelton

CHIEF EXECUTIVE OFFICER

¹ Under the *Companies Act 1993* (the Act), Directors who knowingly make false or misleading statements are liable for penalties of up to five years imprisonment or a fine of up to \$200,000.