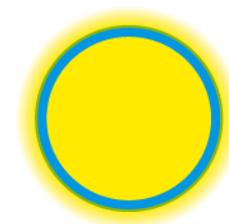


27 September 2017

Keston Ruxton
Manager, EAD Regulation Development
Regulation Branch
Commerce Commission
Wellington

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



Dear Keston

RE: Input methodologies review draft decision - related party transactions

Powerco welcomes the opportunity to comment on the Commerce Commission (the Commission's) consultation paper Input methodologies review draft decisions- Related party transactions, 20 August 2017 (draft decision).

General comments

Powerco supports the Commission's review of the related party transactions in the Input Methodologies (IMs) and the subsequent review of the information disclosure requirements. We consider that the Commission's adoption of a principles-based valuation approach is a practical solution for aligning the related party provisions with the policy intent. This approach should remove some confusion suppliers have in applying the prescriptive rules that are currently in place.

Powerco has read and supports the submission made by the ENA. Our submission focuses on the three areas we wish to discuss further—

- Clarification of the scope and definition of related party transactions
- Implementation of the principle-based approach should be practical and proportionate
- The value of an independent assurance report where related party transactions are 65% of total capital or operational expenditure

Clarification of scope and definition of related party transactions

We recognise the Commission has undertaken significant work over the last year to understand how electricity and gas distributions businesses may be interpreting the related party definition and applying the related party provisions in either the IMs or Information Disclosure Determination (IDD). This has resulted in a revised definition of a related party.

Powerco is concerned that this definition remains unclear and that it extends the scope of what is captured under the proposed related party provisions beyond what is contemplated by the policy intent.

The draft decision defines a related party as being:

- 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

Our concern relates to the second tier of the definition. It is unclear from the information provided exactly what '*parts, branches and divisions*' of a regulated business would be considered to be a related party, i.e. deemed to not supply regulated services.

Powerco currently only has one related party. BasePower is a wholly owned subsidiary that supplies remote area power and storage units. We disclose any transactions with BasePower in our annual information disclosure. Under the proposed definition, it is possible that some of our internal support divisions, such as Human Resources and Finance, could be considered to be 'related parties'.

The uncertainty regarding the scope of this definition also blurs the demarcation between the cost allocation and related party rules. The potential extended scope of the related party rules appears likely to overlap with business transactions that have previously been dealt with under the cost allocation IMs. We suggest that removing the second tier of the definition altogether may be a straightforward way to avoid confusion. This would align the related party definition for regulatory purposes with the GAAP definition well understood by suppliers.

If the proposed definition is retained, we strongly recommend the Commission host a workshop for suppliers and their auditors. This workshop could have a dual purpose. It would:

- clarify the intent so everyone has the same understanding
- provide further examples clarifying how the second tier 'part, branch or division' should be interpreted. This would include how the related party and cost allocation rules work when applied together. These examples could enhance the Determination Guidelines

The IMs and IDD reference the Determination Guidelines (guidelines). It is therefore essential the guidelines reflect the intent of the related party provisions. Increasing the examples provided in the guidelines after the workshop will further assist in explaining how these provisions are intended to be implemented.

Implementation of the principle-based approach should be practical and proportionate

Powerco supports the introduction of the principle-based approach for valuing related party transactions. We understand this requires further information and evidence to assure auditors and other interested parties that the transactions are akin to an arm's length transaction.

The requirements proposed in the draft Information Disclosure Determinations for both electricity and gas distribution businesses are complex and will increase compliance costs for suppliers, and ultimately their customers. The Commission expect these costs to be offset by the benefits gained from increased transparency and assurance.

We suggest the application of the principle-based approach should be practical and proportionate. The draft provisions currently place the same requirements (market testing and extended audit provisions) on all regulated suppliers that carry out related party transactions, regardless of the total value of these transactions. Powerco considers that capturing all related party transactions may lead to the cost of the regime outweighing the benefits and that the scope of transactions captured can be reduced without risking harm to consumers.

We propose the revised IDD compliance requirements should have a de-minimis threshold. For example, in instances where a supplier's total value of related party transactions are a low percentage of its total expenditure, these suppliers could be excluded from the extended related party evidentiary requirements. All suppliers would remain subject to disclosure under schedule 5b of the IDD and auditors would provide assurance, as they do now, that the transaction value is appropriate.

Value of additional independent assurance report

The Commission's proposed provisions would require regulated suppliers to obtain and disclose an additional independent assurance report when—

- related party transactions are 65% or more of a suppliers total capex or total opex, or
- when an independent auditor cannot provide assurance that the related party provisions have been met

Powerco understands the need to require an extra report and assurance if an auditor cannot form a view on whether the related party provisions have been met. The reasons for requiring the same report simply because the value of transactions is $\geq 65\%$ of the total expenditure are less clear. The proposed IDD already provides for –

- Greater transparency
- Increased assurance from expanded auditing requirements
- Assurance from specific director certification

We can appreciate that the Commission's intention is to gain extra assurance over these transactions. But it is unclear from the information provided whether the additional report will deliver any meaningful extra assurance.

If the extra assurance is limited, this requirement will place unnecessary compliance costs on suppliers. Powerco considers that, no matter how large the level of transactions, if the independent auditor is assured the regulated supplier passes all of the proposed related party tests including that the policies are being met, and this is certified by Directors, then this should provide sufficient assurance for the Commission.

We suggest the requirement for this report be amended and only triggered in instances where the auditors cannot form an opinion.

Contact details

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 Nathan Hill tel. (06)759 8582, email nathan.hill@powerco.co.nz.

Yours sincerely



Richard Fletcher
General Manager Commercial and Regulatory