



MAJOR ELECTRICITY USERS' GROUP

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Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Keston

Cross-submission - Related party transactions

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on the submissions by 17 other parties to the Commerce Commission on proposed changes to Input Methodologies and Information Disclosure for related party transactions which closed 27 September 2017.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. This cross-submission discusses two themes in submissions. First, the proposed second limb of the definition of a related party. Second, facilitating efficient and timely adoption of emerging technologies.

Proposed second limb of the definition of a related party

4. The first limb of the proposed definition of a related party refers to a separate related legal entity. The second limb of the definition refers to any part, branch or division of a regulated business that does not supply the regulated service. For brevity, we refer to these as "in-house services." Some EDB have business units that are not separate legal entities; but are substantial businesses. Care should be taken in reading this cross-submission when reading "in-house services" to remember those can include substantial business divisions.
5. Many submitters explained how they currently manage and apply, or not, the existing related party transactions regime for in-house services.²

¹ Refer document URL <http://www.comcom.govt.nz/dmsdocument/15705> at <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/related-party-transactions-provisions/>

² There were many examples and scenarios in the submissions worth the Commission recognising. For example, some referred to permitting consolidation of related party transactions to remove intercompany profit instead of having to test for arm's-length values. This option along with MEUG's suggestion in the past for the need to reconcile regulatory and

6. Most if not all EDB submitters thought that the current regime for in-house services is not broken or at least not sufficiently broken to warrant the proposed changes. They believe that the incentives they face, including the existing related party regime, has and will result in each company making efficient decisions whether to horizontally integrate, out-source or have a mix of both for in-house services.
7. Many submitters explained that the proposed new regime for in-house services was, in their view, not clear and could create higher compliance costs without a greater offsetting benefit to customers. The submission by PwC as an auditor explained possible difficulties in applying the general valuation rule for in-house services.
8. From reading submissions MEUG has doubts that the proposed treatment of in-house services is as close to resolution as might have been hoped for in the Commission draft decision and determination guidance paper of 30 August. In our submission of 27 September, we submitted (paragraph 6) that "MEUG prefer a precautionary approach that can be adapted quickly in the light of new information and changing market behaviour." In relation to defining and regulating in-houses services a precautionary approach would be for the Commission to either:
 - a) Satisfy itself that the issues raised in submissions have been resolved by the proposal and respond to each issue to assure all parties have certainty on how the regime will work; or
 - b) To take stock of issues raised by submitters and re-appraise options for in-house services.
9. We suggest getting the policy setting correct is preferable even if it leads to delaying for 12-months commencement of a complete suite of changes to Input Methodologies and Information Disclosure requirements for in-house services.³

Facilitating efficient and timely adoption of emerging technologies

10. A theme in MEUG's submission was concern that the existing related party transactions regime may not be future-proof to facilitate efficient and timely adoption of emerging technologies by all and any party in the supply chain including customers. Some submitters queried if designing a related party transactions regime for in-house services was the best regulatory tool to consider emerging technology policy issues.⁴
11. Having considered submissions MEUG is unsure if the proposal for in-house services will assist in achieving efficient and timely adoption of emerging technologies. Part of our uncertainty is that there are other regulatory tools that affect emerging technologies outside the remit of the Commerce Commission; such as the work by the Electricity Authority on EDB contract terms and conditions including pricing. A holistic approach across regulators is needed.
12. Another way of viewing this is to consider what harm and potential harm to the long-term benefit of consumers arises from 2 examples of different types of related party transactions. The 2-examples are vegetation management and batteries. In the following 3-paragraphs we consider how differences in those services affect our thinking on the related party transactions regime and the work of the Electricity Authority.

statutory accounts should be considered. This aligns with the suggestion by Vector to consider greater disclosure around inter-company loans.

³ MEUG is not averse in principle to making interim changes that apply to the disclosure year starting 1 April 2018 where those are clearly beneficial for in-house services.

⁴ This section discusses emerging technologies in relation to in-house services only. There is no change in our view of 27 September 2017 that where the related party is a separate legal entity that a continuous disclosure and reserve enforcement approach is best.

13. The policy challenge with vegetation management is to achieve long-term cost efficiency.⁵ If the overall Part 4 regime is working correctly, then an EDB that makes poor decisions on whether to use in-house vegetation management resources or not, will mostly over-time restructure the way it does business. The near-term and long-term harm to customers from an EDB adopting poor vegetation management decisions is, in our view, likely to be less than the risks of poor decisions on use of batteries. Policy settings for regulating in-house services combined with the broader economic regulatory tools of Part 4 alone are sufficient for vegetation management.
14. With batteries, there are multiple possible value streams from the electricity retail, wholesale, ancillary service, distribution alternative and transmission alternative “markets”.⁶ There is a high expectation use of batteries in those markets will grow rapidly whereas vegetation management is unlikely to have material growth across the sector. Regulators need to be vigilant and act promptly to remove barriers to entry and to mitigate unintended consequences to the growing battery market. The regulators, that is the Commerce Commission and Electricity Authority, need to act in concert with one another. Policy settings for regulating in-house battery services combined with the broader economic regulatory tools of Part 4 are alone insufficient. Integration with other policy settings by the Electricity Authority affecting likely value streams associated with batteries also need to be considered.
15. In paragraph 9 above we reached the conclusion that a 12-month delay to making substantial changes to Input Methodologies and Information Disclosure requirements for in-house services related party transactions was preferred if issues raised by submitters could not be addressed. That was consistent with our 27 September submission of taking a precautionary approach. The other part of that prior submission was that regulators needed to be nimble (text underlined for emphasis) “MEUG prefer a precautionary approach that can be adapted quickly in the light of new information and changing market behaviour.” Therefore, we also suggest urgency in developing a holistic approach to regulating EDB in relation to procuring or offering battery services or other emerging technologies that have implications for competition in the wider energy market.

Yours sincerely



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Executive Director

⁵ Cost efficiency, in this case, refers also to innovation and includes efficient profits.

⁶ Refer Transpower, Battery Storage in New Zealand, Discussion document, September 2017, <https://www.transpower.co.nz/about-us/transmission-tomorrow/battery-storage-new-zealand>