24 January 2010

Karen Murray
Chief Advisor
Commerce Commission
PO Box 2351
WELLINGTON

Re: Treatment of transactions between related parties

Dear Karen

The purpose of this letter is to request an amendment to the asset valuation Input Methodology, relating to the valuation of assets purchased from related parties. We believe our request is consistent with the Commission's intentions as explained in the Commission's reasoning, whereas the specification in the Determination creates an un-intended consequence that Unison could not viably purchase from its related party.

In the input methodology for asset valuation, where assets are transferred from a related party to an EDB the transfer must occur at historic cost, or if information is not available on historic cost, market value (clauses 2.2.11 (g) and 5.3.11 (g) of the Determination).

The history of the development of the clause is that originally the Commission required market value supported by an independent valuation for related party transactions. In response to submissions that it may be too onerous for market value for every single transaction[1] or that a threshold should apply for the requirement for independent valuation[2], the Commission specified in the Consultation Update paper that:

> "The Revised Draft Determination provides that, where an EDB purchases an asset from a related party (including an unregulated part of the EDB's business), the asset should be included in the RAB at:
>
> • depreciated historic cost, provided documentation is available to support this; or
>
> • market value, as verified by an independent valuer."

Regrettably, Unison and other submitters did not identify that this wording had not been adopted in the Revised Draft Determination, which specified that market value is only permitted where there is a lack of information on historic cost.

1 ENA (2010) *Submission 8 Valuation Input Methodology Roll Forward of the Regulatory Asset Base From the Electricity Networks Association* para 80

2 Vector (2010) *Submission on EDBs and GPBs (Input Methodology) Reasons Paper, Asset Valuation, 23 August 2010,* p77, paragraph 224

These clauses cause a real problem for Unison and very likely for other regulated suppliers. For example, ETEL is a transformer manufacturing business wholly owned by Unison and, as such, is a related-party. It sells transformers to a number of New Zealand and Australian EDBs, including Unison, which pays market rates for its transformers. Under the Commission's determination, however, Unison would be required to recognise the transformers at historic cost rather than the market value it paid for the asset. Hence, from the Unison Group perspective, we would make a loss on the transformer relative to selling it to a non-related party.

Unison requests that the Commission amends clause 2.2.11 (g) and 5.3.11 (g) to permit market valuations irrespective of whether historic cost information exists. We submit that this change would be in the long-term interest of consumers, as it would allow Unison to continue to purchase ETEL transformers[3] and avoid write-downs of previously installed ETEL transformers, purchased at market rates.

As you might appreciate, Unison cannot afford to write off the margins that ETEL includes in its prices to cover its overhead costs and profits, so we would appreciate an indication from the Commission as early as possible on whether the relevant clauses will be amended.

Yours sincerely

Nathan Strong
General Manager Regulation and Pricing

3 Aside from the fact that ETEL is growing strongly with competitive market rates, ETEL has also developed a "smart" transformer that meets smart grid requirements.