9 March 2012

Regulation Branch
Commerce Commission
Wellington

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SUBMISSION ON INFORMATION DISCLOSURE REQUIREMENTS FOR ELECTRICITY DISTRIBUTION BUSINESSES: DRAFT DETERMINATION AND DRAFT REASONS PAPER

1. Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the "Information Disclosure Requirements for Electricity Distribution Businesses": Draft Reasons Paper (the **paper**) and the Draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination (the **draft determination**) released by the Commission on 16 January 2012.

2. Orion has had the opportunity to participate in the development of the submission on the paper and the draft determination prepared by the ENA. Our submission should be read in conjunction with (and is intended to be complementary to) the ENA's submission. Orion supports the conclusions and recommendations in the ENA submission.

General comments

3. Orion is supportive of information disclosure and we recognise that the Commission has obligations in this respect under the Act and that information disclosure has a specific purpose under the Act. We also recognise that the Commission, under s53B(2)(b);

> *must, as soon as practicable after any information is publicly disclosed, publish a summary and analysis of that information for the purpose of promoting greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time.*

4. We believe that the Commission's focus on meeting its obligations in relation to information disclosure can be achieved in a more sophisticated way than currently is being proposed. We consider that the proposal does not sufficiently integrate the information already disclosed by EDBs in documents like the AMP, information

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provided in compliance with other parts of the Act such as the requirements in relation to DPP (s53N) or disclosures required by the Electricity Authority. We believe that the proposal as drafted requires unnecessary duplication of data and the requirement of large amounts of raw data that would require considerable manipulation by an interested person to draw any conclusions as to whether the purpose s52A and/or s53 is being met.

5. In addition, we believe that it is difficult to reconcile information disclosure obligations. It is possible that an EDB is compliant with the DPP under Part 4 and, at the same time, an 'interested' person may assess, from the information disclosed by the EDB, that the purpose of Part 4 is not being met. We would like to understand how the Commission proposes to resolve this dichotomy. Also we would also like to understand what information the Commission will require an interested person to supply to justify that claim.

Limit information disclosure to no more than necessary

6. Orion is subject to both information disclosure and default/customised price-quality regulation under subpart 9 of Part 4 of the Commerce Act 1986 ("the Act").

7. The Commission has indicated that "*information disclosure is a specific form of regulation under Part 4, with its own clearly defined purpose in s 53A, independent of other regulatory instruments*". Accordingly, the Commission's view is that the requirement for 'sufficient' information to make informed assessments against the Part 4 [determination] should be independent of a supplier's obligation to comply with and provide information under price control regulation. We disagree.

8. To treat information disclosure and default/customised price-quality regulation as independent regulatory instruments in the context of regulation of non exempt EDBs is, in our opinion, incorrect and cumbersome to the extent the same information has to be provided under those regulatory instruments. We believe this to be inefficient and require unnecessary duplication.

9. As we have previously indicated to the Commission,[1] most recently in our November 2011 submission[2], Orion believes that the requirement for non-exempt EDBs to comply with the default price path (DPP) is a higher standard and more onerous than "standard" information disclosure. Regulation of non-exempt EDBs may well focus more on DPP (or where relevant, CPP) compliance than on the information disclosure regime. Requiring repeated disclosure of the same information but in subtly different formats plainly does not accord with the purpose of Part 4 and the Commission should guard against it.

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1 Orion's Submission on Information disclosure September 2009

2 Orion's submission on information disclosure: Approaches to understanding EDB and GPB cost efficiency 10 November 2011

Excessive level of detail and/or duplication of data required

10. We believe that the Commission should limit the information disclosure requirements to no more than that necessary to meet the purpose of the control regime (s52A and s 53A). In doing this the Commission should take into account the other disclosed information such as that in the compliance and monitoring statements required under s 53N.

11. For those non exempt EDBs, s 53N expressly provides for information disclosure with respect to monitoring compliance with price - quality standards:

> *"For the purpose of monitoring compliance with a price-quality path (whether a default price-quality path or a customised price-quality path under this subpart, or an individual price-quality path under subpart 7), the Commission may, in addition to exercising its powers under section 98, issue a written notice to a regulated supplier requiring it to provide any or all of the following:*
>
> *"(a) a written statement that states whether or not the supplier has complied with the price-quality path applying to that supplier:*
>
> *"(b) a report on the written statement referred to in paragraph (a) that is signed by an auditor in accordance with any form specified by the Commission:*
>
> *"(c) sufficient information to enable the Commission to properly determine whether all applicable price-quality paths have been complied with:*
>
> *"(d) a certificate, in the form specified by the Commission and signed by at least one director of the supplier, confirming the truth and accuracy of any information provided under this section."*

12. A statement by an EDB under s 53N will necessarily include sufficient information for the Commission (and interested persons) to assess DPP compliance (and thus whether an EDB is complying with Part 4). This information, together with an asset management plan (AMP) should form the bulk of any information disclosure regime for non-exempt EDBs.

13. Orion is keen to avoid the inefficient duplication of information provision that has existed previously where EDBs supplied compliance statements, AMPs and information disclosure statements which contained much of the same information. This drives real costs into our business not to mention a significant drain on Orion's resources.

14. The Commission must keep front-of-mind the explicit recognition in s 53K that the DPP regime is intended to provide a relatively low-cost way of regulating suppliers. Requiring repeated disclosure of the same information in subtly different formats plainly does not accord with s 53K or with the purpose of Part 4 generally.

15. Related to this, we believe that the Commission's approach in requesting large amounts of detailed raw data to be tabulated is inappropriate, and will not provide interested parties with any meaningful information. An interested party would have to do a considerable amount of work to put into any useful format the data that the Commission is requiring. In Orion's case (and we believe most EDBs) much of this

information has in fact been consolidated into useful and meaningful information and is contained in the AMP together with the appropriate context. Examples of the excessive level of detail and/or duplication of data that the Commission is asking for is much of the information required by schedules 14,15,16,18 and 19 of the draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination.

AMP provides context

16. We encourage the Commission to use information that an EDB already produces rather than require additional information in other formats. Much of the information required for disclosure is already contained in Orion's AMP. This is in a more aggregated form and is, in our opinion, a far more useful form for people to understand. In addition, rather than being just an impenetrable table of numbers our AMP provides a substantial amount of written material to provide a level of context for the reader to assist them in understanding the document.

17. As indicated above much of the information requested in schedules 14 to 19 of the draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination is, in fact, either the same data that is contained in the AMP or in some cases is the raw data behind the aggregated data in the AMP, that has been aggregated to give meaning to that information. In many cases the AMP provides graphical representation of trends in data which in our opinion is far more useful in informing the reader than tables of numbers. We believe that the Commission's approach is inefficient in that it is duplicating data and in many cases presenting it in a less useful manner to interested parties than is already being done as a regulatory requirement in the AMP.

18. The Commission (sub - clause 2 of clause 2.52 of the draft determination) proposes that the purposes of AMP disclosure are that the AMP - :

"Must provide sufficient information for an interested party to assess whether:

1. *assets are being managed for the long term;*
2. *the required level of performance is being delivered; and*
3. *costs are efficient and performance efficiencies are being achieved;*

Must be capable of being understood by an interested person with a reasonable understanding of the management of infrastructure assets;

Should provide a sound basis for ongoing assessment of asset related risks, particularly high impact asset related risks".

We believe that, for non-exempt EDB's, the level of detail that the Commission is requiring of the AMP (the mandatory requirements that must go into an into the AMP are set out over 14 pages in Appendix A of the draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination) to meet these purposes together with the fact that non-exempt EDB's are under price control more than satisfies the purpose of information disclosure set out in s53A of the Act, namely *...to ensure that sufficient information is readily available to interested persons to assess whether the purpose of Part 4 is being met*

Asset management assessment tool (AMMAT) report

19. Should the Commission decide that an AMMAT report (schedule 17) is necessary then we believe that this should be included as an appendix to the AMP. The AMMAT report should only be required to be produced at the same frequency as the AMP (2 yearly) unless the EDB wishes to produce it on an annual basis.

WACC details

20. We do not believe that it is appropriate for the Commission to require EDBs to disclose the mid point estimate of the 25 and 75 percentile of both the post tax WACC and the vanilla WACC. This information is calculated, supplied and publicly disclosed by the Commission. We assume that the inclusion is to allow interested parties to compare an EDB's ROI with the various WACC values. We consider that if the Commission wishes to include this information then the appropriate place would be in the summary and analysis of information that the Commission is required to produce. This approach would also provide the Commission with the opportunity to explain the relevance of any differences between the various values.

Comparative benchmarking

21. We acknowledge that the Commission has an obligation under s53B to publish a summary and analysis of the information publically disclosed by an EDB including their relative performance. Orion already includes, in its AMP, reliability performance comparisons indicating trends over time of our performance against the New Zealand average of other distribution networks across the two main reliability indices (SAIFI and SAIDI).

22. We also measure the reliability of our supply to the Christchurch business district (CBD) against Australian cities (NZ data is not available). We consider that this level of comparison is reasonable.

23. However, we caution against any attempts to carry out more detailed comparative benchmarking. As we noted in our November 2011 submission[3]

[3] Orion's submission on information disclosure: Approaches to understanding EDB and GPB cost efficiency 10 November 2011

" we do not believe that the comparative benchmarking approach proposed in the paper is required, nor do we believe it will add any useful information that the Commission can summarise and analyse to provide interested parties with a greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time (s53B (2)(b)).

There have been a number of attempts at comparative benchmarking in relation to EDBs, including the Commission's previous approach under Part 4A that have been unsuccessful. We believe that the many issues identified in our previous response to the Commission's technical paper on assessing cost efficiency illustrated why previous attempts at comparative benchmarking have failed and also why this proposal to carry out comparative benchmarking will also fail to achieve its purpose."

24. Our experience has been that the 29 New Zealand EDBs are all different, and consequently any assessment of operating expenditure will be influenced by those differences. The EDBs have a range of:

- sizes
- climatic conditions
- overhead/underground mixes
- subtransmission/distribution mixes
- age profiles
- growth profiles
- urban/rural
- tree management
- customer densities
- load profiles
- reliability targets and trends
- cost allocation methodologies
- relationships with contractors
- corporate structures
- alternative sources of energy (eg. reticulated natural gas)
- local geography, including ground conditions and the terrain
- and other factors

all of which somehow have to be meaningfully normalised in order to provide any assessment.

For this reason we consider that comparative data:

- can, at best, provide only broadly indicative information rather than any genuine "truth"

- is potentially misleading.

Pricing

Purpose of pricing disclosures

25. The Commission, in setting out its reasons for the draft decisions on the disclosure of pricing-related information, has identified that, in workably competitive markets, a range of comparative information is available to participants. Consumers and suppliers can compare prices and the quality of goods and services. In markets without workable competition, there is an asymmetric distribution of pricing and related information between buyers and sellers, and consumer's choices are fewer.

26. However as the Commission has previously noted that:

> *The central purpose, [s 52A of Part 4] therefore, is to promote the long-term benefit of consumers in markets where there is little or no competition and little or no likelihood of a substantial increase in competition. 'Competition' in the context of Part 4 of the Act means 'workable or effective competition' (s 3(1) of the Act).*[4]
>
> *This central purpose is to be achieved by promoting outcomes consistent with those produced in workably competitive markets.* [5]

and

> "*... in the context of Part 4, price-quality paths—whether default or customised—by their very nature influence the behaviour of regulated suppliers in a manner consistent with the regulatory objectives in s 52A(1)(a)-(d).*[6] "

27. We believe that the Commission is overstating the benefits that interested persons may be able to derive from the disclosure of pricing information. As indicated from the above quotes, the very nature of price quality paths influences the behaviour of regulated suppliers in a manner that is consistent with the outcomes that would be expected to be produced in a workably competitive market.

28. We believe therefore that a key parameter for an interested person in assessing whether the purpose of Part 4 is being met is whether the EDB is subject to price control i.e. whether the EDB is a non-exempt EDB. If the EBD is non-exempt it is subject to incentive-based price-quality regulation that attempts to mimic some of the pressures that rivalry exerts in workably competitive markets, thereby promoting outcomes consistent with outcomes in such markets.

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[4] Paragraph 2.4.2 Input Methodologies (EDBs & GPBs) Reasons paper 22 December 2010

[5] Paragraph 2.4.3 Input Methodologies (EDBs & GPBs) Reasons paper 22 December 2010

[6] Paragraph 2.7.6 Input Methodologies (EDBs & GPBs) Reasons paper 22 December 2010

29. In relation to quality, the nature of the distribution network is such that most aspects of quality are common so choice is collective. The approach to setting this collective level of quality to meet the purposes of Part 4 is, we believe, already provided by the information disclosure required in the AMP.

30. The Commission has suggested that an interested person would be able to assess whether the purpose of Part 4 is being met if they:

- *know the prices for regulated services*
- *understand how these prices were set*
- *compare prices set for different consumer groups*
- *better understand the extent to which regulated suppliers are applying efficient pricing principles*
- *understand who bears what risks and help assess whether contracts are allocating risks to the party best placed to manage them*
- *assess whether suppliers are sharing with consumers the benefits of efficiency gains in the supply of the regulated goods or services through lower prices (s 52A(1)(c))*
- *assess whether prices reflect the service quality demanded by consumers (s 52A(1)(b)).*

We suggest that

- knowing the prices for regulated services does not of itself tell you how much you pay
- understanding how prices were set is covered by the Electricity Authorities (EA's) disclosure requirements
- the ability to compare prices set for different consumer groups does not necessarily make the comparison meaningful or useful
- sharing benefits with consumers for non exempt EDB's is demonstrated by the DPP
- assessing whether prices reflect the service quality demanded by consumers is already the responsibility of the AMP.

31. The Commission has noted that in developing the ID determinations input was sourced from a range of parties that the Commission considered might be interested persons and that these parties have identified key information gaps including the lack of information on:

- *explanations for changes in prices over time*
- *expected future prices*

- *capital contributions – when they are charged and how the amount is determined.*

32. We would note that in general we get very few questions about these topics and to the extent that they are not covered in our documents, (including regulatory disclosures required by the EA) we are happy to answer questions. We consider that it is more efficient that that we respond when asked to specific questions that a relatively few people may have, rather than to attempt to answer all questions all the time. In relation to specific points identified above that information is perceived to be lacking on:

- *explanations for changes in prices over time:* For a non-exempt EDB, pricing level changes over time will reflect changes in pass through costs, the movement in CPI and the workings of the SPA process. The fact that non exempt EDBs are subject to price control should remove the need for any further explanation. On the other hand, changes in pricing structure over time are the subject of consultation, which is how interested persons would get to understand the rationale for the changes.

- *expected future prices*: Again for non exempt EDB's (if it's about price level) the key drivers are transmission costs, CPI and the SPA. If it's about the need for infrastructure investment then the AMP or a CPP application process should provide sufficient information for an interested party to determine that the purpose of the Act is being met.

- *capital contributions – when they are charged and how the amount is determined:* We agree that a description of current policy or methodology for determining capital contributions as set out in sub-clause 7.1 of clause 2.4 (pricing and related information) of the draft determinations paper should be provided. We do not support the application of sub-clause 7.2 for the reasons expressed by the ENA. Nor do we consider that the requirement to respond to general information requests under sub-clause 8 at any point in time is appropriate in terms of information disclosure However, should the Commission proceed with its approach under sub-clause 8 we would support the ENAs suggestion of allowing 20 working days to respond.

Role of the EA and pricing principles

33. The EA is the lead regulatory agency with respect to pricing methodology disclosure. We believe that the Commission should only include the EA's principles and guidelines by reference, and not as a schedule. The EA will revise the principles and guidelines from time to time and currently plans to review the pricing methodologies of all EDBs during 2012. It would be extremely inefficient if we ended up with different obligations as a result of possible timing issues between regulators.

34. We also consider that there needs to be a clear drop-dead date somewhere, e.g. the methodology needs to be prepared with respect to the guidelines in place at (say) 1 September of the year before the disclosure year: We can't change our pricing

methodology quickly[7], and cannot comply (or not) with principles that do not exist at the time that we begin setting prices.

Views of interested persons on pricing methodologies

35. The Commission notes that a number of stakeholders stated that consumers need more information to both understand how prices change over time, and how they will change in the future. The Commission consider that including this information will enable an interested person to assess more easily whether a supplier is, over time, sharing efficiency gains with consumers and that long term price trends can further assist consumers to make efficient consumption decisions.

36. We disagree. Our experience has shown that it is the stability of pricing products (e.g. day/night product) that allows customers to invest in the long term. In regard to price signals and long term price trends, for non exempt EDBs, this is already being signalled over a 5 year period for EDB's on a DPP with the various pass through and recoverable costs (such as transmission) being outside the influence of the EDB. Similarly, for EDBs on a CPP, there is a 3 to 5 year window where price trends are being signalled.

37. It would be useful if the Commission explained how transmission costs (in particular) are seen from an ID perspective. This is particularly relevant in regard to the idea that we provide a medium term pricing strategy and comments on expected pricing trends. We believe that Transpower, the Commission and the Authority are the parties best placed to comment on this as, between them they determine the level of investment revenue requirement and transmission pricing methodology relating to transmission.

38. In regard to passing through efficiency gains, as we have indicated above, we believe that for non–exempt EDBs the fact that the EDB is subject to price control using either the DPP or CPP is the best indicator to an 'interested' person that an EDB is sharing efficiency gains with consumers.

Other changes to pricing methodology requirements

39. We agree with the proposal that EDBs disclose how they have treated payments (and credits) to and from distributed generations as it clearly shows how all consumers cover the cost of any payments to distributed generation.

40. We do not agree with the proposal to require disclosure in regard to price methodologies and quality as outlined in paragraph 5.31.3: of the paper. This should *not* be a requirement of the pricing methodology. The AMP process is the right place.

[7] Our terms and conditions require consultation in relation to changes of pricing methodology

Consumer consultation can only materially affect anything over the medium to long term, and then only by influencing the way the network is designed and built.

Disclosure in pricing methodologies regarding non – standard contracts

41. We note that, at the pricing workshops, Simply Energy stated that there is little transparency around how non-standard contracts are determined and that consumers have little countervailing power[8]. While it is true, in general, that most consumers have little countervailing power the customers that require a non standard contract tend to be very large consumers (large industrials for example) that do, in our experience, have significant countervailing power, and indeed want the contractual terms to be non-standard.

Disclosure of methodology for determining capital contributions

42. See our earlier comments in regard to capital contributions at paragraph 32 above. Having said that we note that the Commission indicates that for nearly a third of all EDBs capital contributions represent more than 10% of total regulatory income. The PWC Electricity Lines Business Information Disclosure compendium for 2009, 2010 and 2011 indicates that both capital contributions and gross value of vested assets as a percentage of regulatory income is on average 5.7%, 4.2% and 4.2% respectively, and the number of EDB's above 10% varies considerably from year to year. We believe this reflects the spikey nature of the establishment of large connections on relatively small networks. We believe the Commission should consider whether there should be some de minimus below which the capital contribution disclosure requirements do not apply. Orion has never received anywhere near 10% of regulated revenue from capital contributions.

Disclosure of prescribed terms and conditions of contract

43. The Commission in section 5.7 of the draft reasons paper sets out a number of requirements relating to disclosure of information regarding terms and conditions we make the following comments:

- Paragraph 5.48: Terms and Conditions are generally *not* with consumers (in an 'interposed' situation). Practically superior (to other consumers) terms cannot in most cases be delivered.

- Paragraphs 5.52.and 5.53: the Electricity Authority's workstream on model use of system agreements and recent Electricity Industry Participation Code changes cover much of this territory. Why should we disclose that we have to comply with regulation?

[8] Paragraph 5.35 *Information disclosure requirements for EDBs Draft Reasons paper* 16 January 2012

- Paragraph 5.54: we do not understand the argument that because the Authority has made regulation in this space disclosure is more important

- Paragraph 5.56: we do not consider that this proposal is practical. We might be able to say something sensible about "standard services", but this doesn't guarantee that everyone actually gets the same service levels, at least in the short term, or that the actual assets feeding them (to the extent it is meaningful to talk about this at all) are in some sense standard.

Related Party Transactions

44. We are concerned by the draft proposals in relation to disclosure regarding related party transactions.

45. There is a wide variety of operational arrangements with respect to how EDBs source maintenance, capital works and other functions of their operations. We believe that in most cases the arrangements chosen by an individual EDB reflect a local response to the EDB's desire for cost minimisation; to encourage learning and innovation and to achieve economies of scope and scale.

46. Many EDBs provide most of their requirements "in-house", whereas others use related or third-party service providers for most of their needs, and others are somewhere between the two extremes.

47. Orion sits towards the outsource end of the continuum – and we've done so since the mid 1990s. We competitively tender our capital and maintenance works.

48. We have a wholly-owned subsidiary company, Connetics Limited, which along with unrelated contractors tenders for works. We also negotiate to buy the reticulation in new subdivisions from developers so Connetics and other contractors negotiate directly for that with developers. Around half Connetics' work comes from Orion. Connetics undertakes around half of Orion's maintenance and capex work.

49. Our experience has been that operating a "full" contracting market with multiple tenders received for every project, even in a market the size of Canterbury, is complex (and therefore costly). Much of the work is highly specialised and maintenance work on or near live electrical equipment requires us to ensure that any contractors have appropriate skills and experience – for their own and public safety and also for wider network safety and reliability issues. With respect to cable and equipment installed on our network, we also ensure that certain minimum standards are met. The long-term costs of poor cable or equipment quality are very significant.

50. It is in our long term interests to ensure that we keep an active market for the provision of electrical maintenance and construction in the Canterbury region, but given the size of the markets and the specialised services involved it is unsustainable to have more than two major contractors in each of our main work categories (cables, overhead and substations). We consider that it is unsustainable to have large

number of contractors in our market given the need to provide extensive specialised training, to achieve economies of scale, to provide safety systems and given the amount of work available. All these issues impact the way that our tender practices are able to operate.

51. We do not operate a "public notice" style of tendering. We invite tenders from a limited sustainable pool – those who have met the standards we require and become approved contractors. We attempt to keep multiple skilled contractors available in each broad category. At times we have moved positively to encourage new contractors to enter or existing contractors to remain in our market. For example, a few years ago we provided a loan to enable one of our rural tree maintenance contractors to upgrade equipment.

52. In some cases we may only invite a tender from one party because we are aware of the high workloads of existing contractors, or because we want to ensure that a previously unsuccessful contractor is kept in the market. We do not inform the party that it is the only tenderer. In some cases only one contractor has the relevant skills to undertake the work – for example, Connetics currently does all of our 66kV cable jointing work. It is in our (and our customers') long term interests to have a sustainable number of competent and safe contractors in the market.

53. We established Connetics as a stand alone subsidiary in 1996 for a number of reasons. Among other things there are significant cultural differences. We wanted Connetics to focus on genuinely competitive pricing and innovation without the "guarantee" of work from our network business and to learn innovative new ways of undertaking tasks pushed by competitive pressures; and we wanted Connetics to be able to trade widely without allegations of cross-subsidy. Our practice is to keep the senior Orion managers involved in the governance of Connetics away from the tender process – both at Orion and Connetics.

54. Virtually all of our tenders are awarded on a lowest price conforming tender basis (we might award work without a tender occasionally for commercial reasons to a contractor to encourage them into the market or to stay in the market). However, in some circumstances:

    54.1. we may award a few contracts with Connetics as the only tenderer – without Connetics being aware that the contract is uncontested, so this process should still provide the same outcome as workable competition

    54.2. we may award some contracts to Connetics where they are the only tenderer in the market (eg, 66kV cable joints)

    54.3. we have a negotiated rates agreement with Connetics for emergency repair services in our urban area (our rural area is with another contractor)

54.4. we have a negotiated cable management agreement with Connetics which sets quality standards and prices for all cable to be installed on our network, or as a component of a new subdivision.

55. Our clear intention within the bounds of a limited local market is to encourage as much of a sustainable competitive tendering environment as we are able, and to as much as possible mimic a wider competitive market.

56. We are concerned that the proposed 17.2% margin, as yet not fully defined, will lead to considerable complexity with transfer pricing. There will undoubtedly be costs involved in yet another regulatory impost such as this. We already have some tax and accounting differences from our regulatory values, and it would be unhelpful to generate yet another set of differences.

57. We are concerned that a possible consequence of this proposal is that we might eventually elect to sell our interest in Connetics to simplify all of our regulatory arrangements. However, the considerable risk that we would face by doing so is that the purchaser could in turn elect to move out of part or all of the lines of business which currently support Orion, and even choose to leave the Canterbury region. Further, we could certainly lose our ability to control the availability and quality of contracting resource on our network. Owning part of Connetics increases the chance that Connetics will be prepared to make investment in staff, materials and equipment that are specific to Orion contracts. It will be less concerned that Orion would take advantage of this specific investment by insisting on a price that does not cover the cost of the investment.

58. In light of our own circumstances and experiences we turn to the Commission's proposals.

59. The Commission has proposed that an EDB should be allowed to include the actual price at which it purchased the goods or services from a related party transaction in its information disclosures:

- *where the related party makes at least 75 per cent of its sales to unrelated parties and the prices charged to the regulated supplier are demonstrably the same as those charged to unrelated parties;*
- *where the services in question had previously been outsourced and the regulated supplier can demonstrate that the cost of supply from the related party was the same or less than the costs incurred under the previous outsourced arrangement;*
- *where the value of all transactions with that related party is less than one per cent of the regulated supplier's total revenue from the regulated service for that year and the total value of all related party transactions is less than five per cent of the regulated supplier's total revenue from the regulated service; and*
- *where an open tender has been used and the directors can certify that the tender was open, that it was run to ensure that there were credible competing tenders, and the lowest qualifying tender was selected.*

60. We consider that these rules are overly prescriptive, poorly defined and extremely tight, and believe that as written despite our tendering model we might fail to "fit" within the Commission's proposed categories.

61. To take them in turn:

- *where the related party makes at least 75 per cent of its sales to unrelated parties*… the tender prices we receive from contractors are a mix of labour, materials and plant with different construction conditions and distances. How is it envisaged that prices charged to the regulated supplier can be **proven** to be *demonstrably the same* as those charged to unrelated parties? We also submit that the 75% threshold is overly tight and that a lower threshold at or below 50% should be the hurdle. It is also not clear why such a rule and such a threshold is needed to ensure that the market is workably competitive, as noted above, Connetics makes around 50% of its sales to unrelated parties.

- *where the services in question had previously been outsourced…*this suggests that the services, once acquired externally, are now provided internally. Once brought back in-house, how and when would on-going verification be required to ensure that current costs and past costs are still in line, and also still represent like for like – that is, no increase or decrease in quantity and quality of service? Further, this would lead to a reduction in competitive pressure as the constant monitoring to an external market would cease.

- *where the value of all transactions with that related party is less than one per cent…* we consider that this 1% per related supplier and 5% for all related suppliers is far too narrow a band –. We submit that these very narrow bands should be extended. We recommend that the overall value of transactions be extended to at least 10% and that the per supplier transaction limit is removed. If not, some other approaches may be taken (eg, the inefficient restructuring of related parties to make them into multiple smaller entities).

- *where an open tender has been used…*what is meant by an "open tender"?. Are two parties, one related, one unrelated, sufficient to provide an "open tender"? Our experience has been that for our specialised work categories it is not sustainable in our market to have more than two tenderers. Also, as noted above, there might be circumstances where the lowest qualifying tender is not accepted for sound commercial reasons. It is not necessary for a tender to be 'open' in order for it to result in an outcome consistent with a workably competitive market. The Commission could analyse the circumstances of each block of tenders (that is those let to multiple parties etc), and perhaps tenders over time, in addition to the market circumstances to determine whether it would result in an outcome consistent with a workably competitive market.

62. We believe that some combination or hierarchy of the above rules, amended as we have suggested, might work in our circumstances and still provide some regulatory overview with respect to transfer pricing.

63. For example, if the Commission were to firstly ring-fence those related party transactions which were subject to an open tender process (subject to our concerns over definitions) and exclude them from the other categories, then the work we award Connetics on a non-tendered basis would be a very small component (less than 1%) of our overall regulated revenues, and it would be a small component (maybe 5% or so) of Connetics' overall revenue with respect to their total third party revenue.

64. The Commission has also proposed that if an EDB cannot meet any of the four criteria above, it should include the value of a related party transaction in its information disclosures on one of the following transfer pricing methods:

64.1. at the cost incurred by the related party providing the service;

64.2. at the direct cost incurred by the related party providing the service plus a mark-up on direct costs that does not exceed 17.2 % where the transaction involves electricity contracting services; or, alternatively

64.3. the transaction should be disclosed at a nil value.

65. We do not support the way in which the above transfer pricing methods have been derived and defined. There is no definition of *the cost incurred by the related party undertaking the service* nor is there any clarity about how the *direct cost incurred by the related party providing the service plus a mark-up on direct costs that does not exceed 17.2%* might actually be defined. We note the work that NERA has undertaken for the ENA in relation to this aspect of the Commission's paper, and endorse the comments in the NERA paper.

66. In summary, we submit:

66.1. that the cost of implementing a process as proposed outweighs the benefits which might be achieved, and

66.2. that the old style cost accounting approach proposed by the Commission is totally incompatible with an outsourcing model.

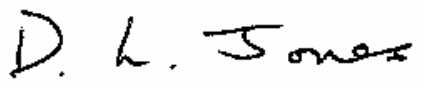
Endorsement of the ENA's recommended alternative approach

67. As indicated above we endorse the ENA's submission and its recommendations.

Concluding remarks

68. Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact either Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email dennis.jones@oriongroup.co.nz or Graeme Wilson (Management Accountant), DDI 03 363 9653, email graeme.wilson@oriongroup.co.nz

Yours sincerely



Dennis Jones
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