

10 August 2020

Dayle Parris  
Orion New Zealand Limited  
Email: [dayle.parris@oriongroup.co.nz](mailto:dayle.parris@oriongroup.co.nz)

By email

Dear Dayle,

**Orion third party financing of new investment contract on [REDACTED]**

1. Thank you for your emails of 31 January, 10 February and 9 March 2020 seeking guidance from us on our approval process in respect of third-party financing of *new investment contracts* under the *Electricity Distribution Input Methodologies Determination 2012* [2012] NZCC 26 (EDB IM).
2. We understand you would like this guidance because Orion is considering refinancing an existing *new investment contract* for the [REDACTED] assets from Transpower (the current provider of the GXP assets and financier under the contract) to a third-party financier. Should it do this, Orion intends to seek Commission approval under clause 3.1.3(1)(c)(ii) of the EDB IM so that it can allocate its charges payable under the financing of that agreement as recoverable costs.
3. In your emails you ask us to explain:
  - 3.1 the process the Commission expects to follow when considering whether to approve the financing of a *new investment contract* under clause 3.1.3(1)(c)(ii) of the EDB IM, including any specific information requirements Orion would need to satisfy; and
  - 3.2 how the term of the financing contract would be treated if it is less than the remaining term of the existing *new investment contract* with Transpower. You sought our clarification of how back-to-back loan contracts would work in these circumstances. In particular, whether we would expect to require new applications each time an approved third-party loan is rolled over or renewed.

4. The remainder of this letter is structured as follows:
  - 4.1 Paragraphs 5-8 provide a summary of the approval process we expect to follow when considering whether to approve the financing of a *new investment contract* under clause 3.1.3(1)(c)(ii). This section responds to your query described at paragraph 3.1.
  - 4.2 Paragraphs 9-11 respond to your queries described at paragraph 3.2; and
  - 4.3 Paragraphs 12-16 provide a general discussion of how, in contrast to Orion's circumstances where there is an existing *new investment contract*, we would expect to follow a more extensive approval process for third party financing relating to a newly-established *new investment contract* with Transpower or with another transmission provider. Orion did not request this information, but we considered it is helpful to include.

#### **Summary of Commission approval process**

5. The specific approval process we expect to follow under clause 3.1.3(1)(c)(ii) will depend on the circumstances of each *new investment contract*.
6. With this in mind, we have identified information requirements that we think, at a minimum, Orion would need to satisfy in relation to the existing [REDACTED] *new investment contract* and the third-party financing. We consider Orion would need to provide us with information that shows the following:
  - 6.1 the existing [REDACTED] contract meets the definition of a 'new investment contract' provided in the Electricity Industry Participation Code (the Code);
  - 6.2 the existing [REDACTED] contract meets the requirements of clause 3.1.3(1)(c)(i) of the EDB IM. This is required in order for the charges under the new investment contract (inclusive of financing charges levied by Transpower in the contract charges) to be treated as a recoverable cost for Orion's price path under the DPP;
  - 6.3 the financing meets the requirements of clause 3.1.3(1)(c)(ii) of the EDB IM. Specifically, that the "charge payable" by Orion is:
    - 6.3.1 to a party that is "not a related party"<sup>1</sup>; and
    - 6.3.2 for the purpose of Orion receiving finance in order to pay amounts payable under the existing [REDACTED] contract;

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<sup>1</sup> 'Related party' is defined in clause 1.1.4(2) of the EDB IM to mean "(a) a person that is related to the EDB, where the EDB would be considered as the 'reporting entity', as specified in the definition of 'related party' in NZ IAS 24; or (b) any part of the EDB that does not supply electricity distribution services;"

- 6.4 the new third-party financing costs that would apply over the remaining term of the existing [REDACTED] contract are expected to be no more than the original Transpower financing arrangements based on the terms of Orion’s financing agreement. This information would need to be supported by a copy of the funding agreement or, if the negotiation of the funding arrangement is still under way when we review Orion’s application, alternative evidence such as a term sheet; and
- 6.5 because we understand from you that the financing from the third-party for the [REDACTED] contract may go into a general pool of financing for all of Orion’s assets, information that:
- 6.5.1 distinguishes the “charge payable” each year in respect of the financing of the repayment to Transpower under the existing [REDACTED] contract from Orion’s general financing pool. We think this is necessary to show because the cost of the financing needs to be distinguishable from the general financing pool in order to determine the value of the recoverable cost. An example of how Orion could show this would be to provide us with an schedule of charges showing the split between principal and interest compared to the original Transpower charges; and
- 6.5.2 describes how any general pooled financing amounts would be recalculated as the costs of the general pooled financing facilities periodically changed.
7. We have not specified how Orion must provide us the information described in paragraph 6. However, we note that the information described in paragraphs 6.1-6.5 is intended to assure us that the existing [REDACTED] *new investment contract* and the third-party financing satisfies the relevant requirements provided in the EDB IM and the Code, and that Orion won’t be incurring higher costs under the new third-party financing costs than they would be under the original financing arrangements. With this in mind, we consider that one option that may provide us the appropriate level of assurance would be to provide the information described in paragraphs 6.1-6.4<sup>2</sup> in the form of a directors certificate.<sup>3</sup>
8. If the Commission approved the financing under clause 3.1.3(1)(c)(ii), we consider that that approval would be subject to the requirements in paragraph 6.1-6.3 being satisfied at all times.

<sup>2</sup> We have excluded paragraph 6.5 here, as the information we are requiring in paragraph 6.5 is asking for technical information regarding financial pooling.

<sup>3</sup> Should Orion seek to do this, the wording of the certificate would need to be agreed between us and Orion, but we anticipate that it would follow similar wording to that provided in the director certificate forms in Schedules 6-7 and 9-11 of the *Electricity Distribution Services Default Price-Quality Path Determination 2020* (Consolidated 20 May 2020).

*Circumstances when third party financing is rolled over or renewed*

9. You asked whether the Commission would expect to require new applications each time an approved third-party loan is rolled over or renewed. In response to this query, if there has been a change in the terms of the third-party financing agreement (as approved by us), or the financing agreement has been renewed/rolled over, or a new financing agreement has been put in place, we would expect Orion to notify us of the change, and provide any updated information consistent with paragraph 6.5 if finances are pooled, including confirmation that :
- 9.1 the new terms, or the rolled-over/renewed terms, have been made after a process that considered the costs of all other third-party funding options and represent the terms most favourable to consumers at that time: and
- 9.2 the requirements described in paragraphs 6.1-6.3 are still met.
10. We would expect that information regarding any changes in the terms of the financing arrangement would be provided to support the recoverable costs disclosed in Orion's Annual Compliance Statement.
11. We note for completeness that the repayment amount to Transpower to satisfy the financial aspects of the existing *new investment contract* would not be regarded as a recoverable cost for the purposes of clause 3.1.3(1)(c)(i) of the EDB IM. Only the future charges payable on the borrowings (principal and interest) would be a recoverable cost under clause 3.1.3(1)(c)(ii).

**Differences between establishing a new investment contract compared to refinancing existing arrangements**

12. The specific approval process we expect to follow under clause 3.1.3(1)(c)(ii) will be tailored to fit the circumstances of each *new investment contract*.
13. In contrast with Orion's refinancing proposal, the approval process for any newly-established *new investment contract* with Transpower or with another transmission provider would probably be more extensive than set out in this letter, as there would not be an existing contract to use as a point of reference, as there is currently with the existing [REDACTED] new investment contract. Clause 3.1.3(1)(c) of the EDB IM sets out what types of charges payable by an EDB in respect of a new investment contract may be considered recoverable costs of that EDB. It states:

(1) A recoverable cost is a cost that is-

...(c) a charge payable:

(i) by an EDB to Transpower in respect of a new investment contract (as 'new investment contract' is defined in the Electricity Industry Participation Code) between those parties, or subject to the prior approval of the **Commission**, an equivalent type of contract with another transmission provider; or

(ii) by an **EDB** to a party that is not a **related party** to the **EDB**, for the purpose of the **EDB** receiving finance in order to pay amounts payable under a new investment contract (as 'new investment contract' is defined in the Electricity Industry Participation Code) between the **EDB** and **Transpower**, or an equivalent type of contract with another transmission provider, in each case subject to the prior approval of the **Commission**;

14. There is no requirement under clause 3.1.3(1)(c)(i) of the EDB IM for prior Commission approval of new investment contracts between Transpower and an EDB. Each contract will be made on different terms and, in this respect, the requirement in subclause (1)(c)(i) is satisfied by a negotiated contract between Transpower and an EDB that complies with the definition of 'new investment contract' given in the Code.<sup>4</sup>
15. The situation is different where an EDB is engaged in third-party financing of a *new investment contract* between Transpower and the EDB. Where an EDB seeks to recover costs associated with third party financing of a *new investment contract*, clause 3.1.3(1)(c)(ii) of the EDB IM requires that the EDB apply to the Commission for prior approval of that agreement.
16. As discussed in our November 2019 EDB IM reasons paper, the requirement in clause 3.1.3(1)(c)(ii) for prior Commission approval was explicitly included to ensure an appropriate level of scrutiny is applied to any new third-party contract.<sup>5</sup> As we note in that paper, the requirement for prior Commission approval is consistent with:<sup>6</sup>
  - 16.1 our view in our 2010 IM reasons paper, which noted that the EDB has a degree of control over these types of costs, and therefore it is appropriate for us to assess applications for approval of recoverable costs on a case-by-case basis; and
  - 16.2 Transpower's *new investment contract* requirements, as defined in the Transpower IMs, which includes, among other things, a requirement for Transpower to demonstrate that the terms and conditions of the contract were determined following a process that provided opportunities for Transpower's affected customers to make or approve reasonable price-quality trade-offs; and the competitive provision of new electricity transmission services by parties other than Transpower.

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<sup>4</sup> The definition of 'new investment contract' is provided in Schedule 12.4 of the Code, and states "new investment contract means a contract entered into at any time between Transpower and a customer of Transpower, under which Transpower agrees to provide any new or upgraded grid assets and the customer agrees to pay charges based on Transpower's cost of providing the new or upgraded grid assets. It includes, but is not limited to a new investment agreement contract as defined in Part 1 of this Code"

<sup>5</sup> Commerce Commission *Amendments to Electricity Distribution Services Input Methodologies Determination: Reasons paper* (26 November 2019), at [3.67].

<sup>6</sup> Commerce Commission *Amendments to Electricity Distribution Services Input Methodologies Determination: Reasons paper* (26 November 2019), at [3.67].

**Next steps**

17. If you have any further questions on the [REDACTED] *new investment contract* or any other potential contract, please contact either Matthew Lewer or Paolo Caccioppoli.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'EW', with a long horizontal flourish extending to the right.

Elisabeth Welson  
Commissioner