Related parties

CitiPower

Regulatory proposal 2021–2026

CitiPower

December 2019

Contents

1 Related parties

This appendix provides information as at December 2019 on our corporate and organisational structure currently in place or expected to be in place during the 2021–2026 regulatory period.

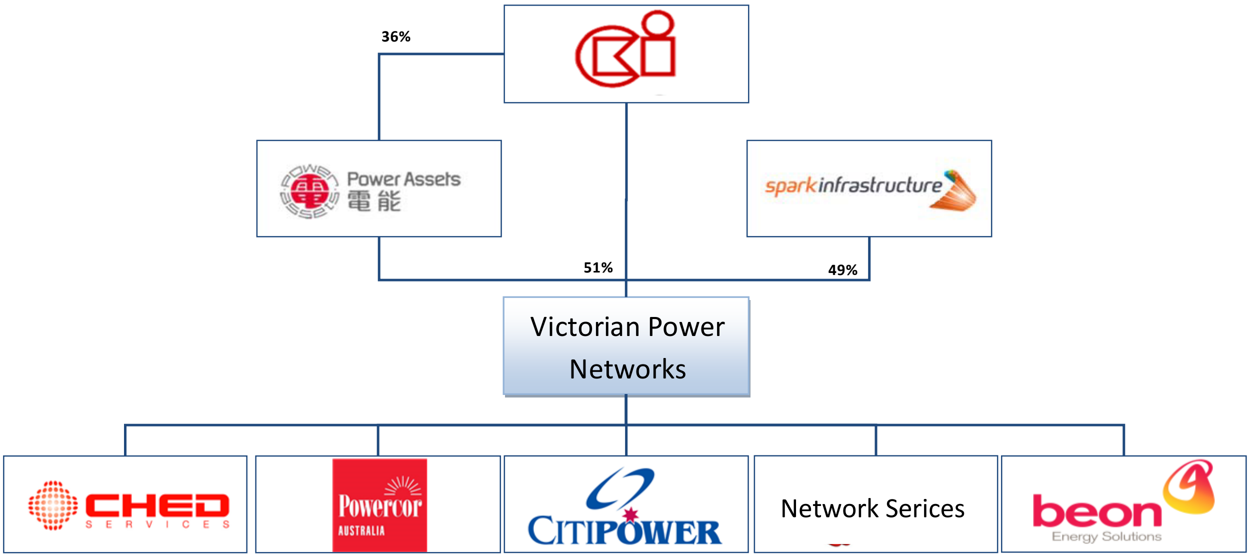
1.1 Corporate structure

Our ownership is divided between CK Infrastructure, Power Assets Holdings and Spark Infrastructure:

- CK Infrastructure and Power Assets Holdings, which are members of the CKI Group of companies, based in Hong Kong, hold a 51% stake in our business.
- Spark Infrastructure, which is listed on the Australian Stock Exchange, owns the remaining 49%. Its focus is investing in regulated utility infrastructure, such as electricity, gas, water and sewerage assets.

This ownership structure is shown in figure 1.

Figure 1 Group structure



Source: CitiPower

Our corporate structure includes a number of related parties that contribute to the provision of distribution services. These related parties are discussed below.

1.1.1 CHED Services Pty Ltd

In 2005, CHED Services Pty Ltd (**CHED Services**) was created as a separate legal entity to provide specialist corporate services. These services are provided to us under a corporate services agreement. CHED Services also administers a discretionary risk management scheme (**DRMS**) of which we are a member. These service agreements, and the DRMS, are discussed in section 1.2.

1.1.2 Powercor Network Services Pty Ltd

In 2008 Powercor Network Services Pty Ltd (**PNS**) was created as a separate legal entity to provide specialist construction and maintenance services. These services are provided to us under a network services agreement. From 1 January 2020 PNS will change its name to Network Services Pty Ltd. This service agreement is discussed in section 1.2.

1.1.3 Powercor Australia Limited

Powercor Australia Limited (**Powercor**) is a related party, and we each hold a separate electricity distribution licence for a defined geographical electricity distribution area in Victoria. Both networks are jointly managed and operated by our own personnel and systems.

1.1.4 Energy Solutions Pty Ltd

For completeness, we note that another related party, Energy Solutions Pty Ltd trading as beon Energy Solutions (**Beon**), provides contestable energy services to third parties. Beon does not provide services to CitiPower or Powercor.

1.2 Service agreements

As set out in section 1.1, we have entered into service agreements with related parties. These service agreements are set out in table 1, and confidential supporting documents are attached with our regulatory proposal.[1]

Table 1 Service agreements between related parties

Service agreement	Provider	Recipient
Corporate services agreement	CHED services	CitiPower
Network services agreement	PNS	CitiPower
Discretionary Risk management scheme	CHED services	CitiPower
Resources agreement	CitiPower	CHED services and PNS
Cost sharing agreement	CitiPower	Powercor

Source: CitiPower

We negotiate these service agreements directly with our related parties and not subject to a competitive tender process. These negotiations are undertaken on a stand-alone basis; individual engagements are not part of a broader operational agreement.

The service agreement negotiations are undertaken under strict and established governance principles for the engagement of related parties. The principles ensure commercial contract terms, including:

- the service provider is required to pass through scale efficiencies where it provides the same or similar services to other entities. This provides efficiencies that would not otherwise be available to us operating on a stand-alone basis.
- the service provider may be penalised (through lower payments) should it repeatedly underperform relative to key metrics.

[1] CP ATT126 - Cost sharing agreement - Dec2019 - Confidential, CP ATT127 - DRMF Constitution - DATE - Confidential, CP ATT128 - Network services agreement - Dec2019 - Confidential, CP ATT129 - Resources Agreement 2017 (CP to CHED) - Dec2019 - Confidential, CP ATT130 - Resources Agreement 2017 (CP to PNS) - Dec2019 - Confidential, CP ATT131 - 03 Corporate Services Agreement 2017 - Dec2019 - Confidential, CP ATT132 - 04 Corporate Services Agreement 2017 - Dec2019 - Confidential

- we do not have an obligation to accept offers from PNS for project services. Further, there is express provision in the network services agreement for us to seek competitive tenders for similar services to those provided by PNS. This ensures PNS faces an incentive to price services efficiently.
- we are only required to pay for the services we actually receive from related parties. This mirrors the competitive market supply of services.
- we can terminate the agreements with 60 days' notice or if the other party is in breach of an essential term and does not remedy the breach.

These service agreements have enabled scale and scope efficiencies that would not otherwise be available if we operated on a stand-alone basis. These efficiencies are supported by the following:

- the AER's benchmarking analysis shows that we are the second most efficient distribution network in Australia. A key driver of our overall efficiency is the structure and rigour of our related party transactions.
- the AER has previously stated that given the incentives to minimise costs in the regulatory regime—such as the Efficiency Benefit Sharing Scheme (**EBSS**)—the revealed operating costs of a distributor are likely to be a reasonable approximation of efficient costs in the circumstances of that distributor for the scope of work undertaken. Our total operating expenditure has been subject to an EBSS throughout the 2016–2020 regulatory period. Consistent with the incentive framework, therefore, we believe our actual operating expenditure in our base year (2019) is efficient.
- as a privately owned business we have an obligation to maximise returns to shareholders. This contrasts with publically owned utilities that may face competing, non-commercial incentives that limit their responsiveness to profit based incentives.
- as a privately owned business, we also face scrutiny on our financial performance, beyond that of the regulator. For example, we raise financing from multiple parties. These multiple parties each continually monitor our performance, and the consequences of poor management—such as incurring inefficient costs impact on the capacity of the business to raise further capital. This provides further discipline on us to maintain an efficient expenditure profile.
- all investment cases prepared must provide adequate information about how the investment contributes towards our longer term strategic behaviour. Secondly, business cases require approvals from governance-committees, including the Network Investment Committee (**NIC**) and the VPN Investment Committee (**VPN - IC**). This ensures our network planning and management objectives align with our regulatory and corporate strategic objectives.
- all of our proposed capital investment is appraised and approved through a single process. This ensures a consistent investment appraisal criterion is applied to all investment decisions. The governance process delegates approval responsibility appropriately to the Business Unit Senior Managers (investment lower than $600,000), the NIC ($600,000 to < $2 million) and VPN-IC (greater than $2 million). Further, this process is subject to periodic review and audit.

A description of our service agreements with related parties are set out below.

1.2.1 Corporate services agreement

Under the corporate services agreement, CHED Services provides us with services including the chief executive officer; finance; the company secretary and legal; human resources; corporate affairs; customer services; information technology; and office administration.

The pricing of services under the corporate services agreement is principally based on a fixed charge plus disbursements, noting that the services may comprise standard services and project services. The pricing is subject to scheduled review and indexation for inflation.

For the purposes of this agreement, CHED Services subcontracts services as needed.

1.2.2 Network services agreement

Under the network services agreement, PNS provides us with services including customer and connection services; asset replacement maintenance services; asset performance (fault) services; and network development.

The pricing of services under the network services agreement is based on a mix of fixed price services, unit rates, materials charges, labour rates and disbursements, noting that the services may comrpise standard services and project services. The pricing is subject to scheduled review and indexation for inflation.

For the purposes of this agreement, PNS subcontracts services as needed.

1.2.3 Discretionary risk management scheme

CHED Services established the DRMS in 2004, and continues to administer the scheme. We use the DRMS to manage our exposure to certain events which fall outside our insurance policy deductibles.

The DRMS retains funding reserves, based on contributions we (and other clients) make, in order to enable CHED Services to meet the cost of claims under the DRMS. There is a three per cent administration fee to cover the actual costs of administering the DRMS.

1.2.4 Resources agreement

Under the resources agreements, we provide staff to CHED Services and PNS. In turn, CHED Services and PNS pay us for wages and salaries (including bonuses, allowances, leave payments, fringe benefits, fringe benefit tax, payroll tax, superannuation payments and work cover payments); operating expenses that are incidental to the provision of the services (including phone calls and stationary); and motor vehicle expenses relating to provision of the services.

The pricing of services under the resources agreements is at cost.

Under this agreement services are further outsourced as needed.

1.2.5 Cost sharing agreement

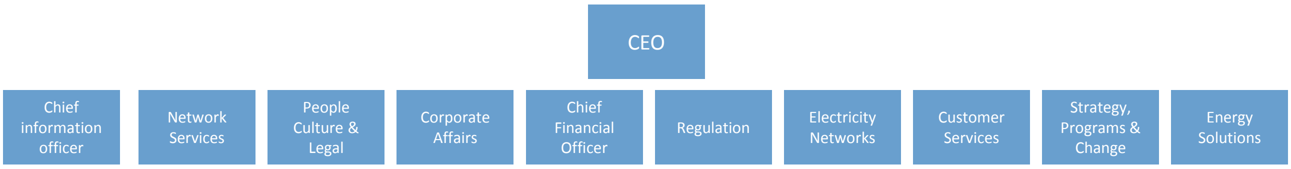
Under the cost sharing agreement, an annual payment is made between us and Powercor. This payment is based on the pooling of defined overhead costs, and the reallocation of those costs to each distributor based on a defined formula. The difference between the reallocation amount and the actual cost incurred by each distributor is the amount that is paid by one distributor to the other.

The agreement does not explicitly cover outsourcing arrangements.

1.3 Organisational structure

Our organisational structure is set out below, in figure 2.

Figure 2 Organisational structure



Source: CitiPower