



## ***Independent Appraiser's Report***

To the Directors of Alpine Energy Limited and the Commerce Commission

### ***Independent Appraiser Report on Related Party Transactions Pursuant to Electricity Distribution Information Disclosure Determination 2012***

The Auditor-General is the independent appraiser of Alpine Energy Limited (the 'Company'). The Auditor-General has appointed me, Nathan Wylie, using the staff and resources of PricewaterhouseCoopers to provide a report, on behalf of the Auditor-General, on:

- whether the Company's basis for valuation of related party transactions ('valuation of related party transactions'), has complied, in all material respects, with clause 2.3.6 of the Electricity Distribution Information Disclosure Determination 2012, as amended by the Information Disclosure exemption: Disclosure and auditing of reliability information within schedule 10, issued by the Commerce Commission on 9 April 2020 (the 'Information Disclosure Determination, as amended'), and clauses 2.2.11(1)(g) and 2.2.11(5) of the Electricity Distribution Services Input Methodologies Determination 2012 ('the Input Methodologies Determination'); and
- whether the steps taken by the Company, as specified under the "Summary of steps and analysis undertaken by the Company to test compliance" are considered to be, in all material respects, reasonable in the circumstances.

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### ***Opinion***

In our opinion:

- the basis for valuation of related party transactions for the disclosure year ended 31 March 2020 complies, in all material respects, with the Information Disclosure Determination, as amended and the Input Methodologies Determination; and
- the steps undertaken by the Company, as specified under the "Summary of steps and analysis undertaken by the Company to test compliance" are considered to be, in all material respects, reasonable in the circumstances.

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### ***Basis for Opinion***

We conducted our engagement in accordance with ISAE (NZ) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* and SAE 3100 (Revised) *Compliance Engagements* to obtain reasonable assurance that the Network has complied in all material respects with the relevant related party valuation requirements as set out in the Information Disclosure Determination, as amended and the Input Methodologies Determination for the year ended 31 March 2020.

In forming our opinion, we have obtained sufficient recorded evidence and all the information and explanations we have required.



### Other matter

The Independent Appraiser Report on Related Party Transactions Pursuant to Electricity Distribution Information Disclosure Determination 2012 for the disclosure year ended 31 March 2019 was disclaimed. We were not able to obtain sufficient appropriate evidence, or obtain all the information and explanations we required, to form an opinion on whether the basis for valuation of related party transactions for the disclosure year ended 31 March 2019 complies, in all material respects, with the ID Determination and the IM Determination.

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### Our approach

#### Materiality

Our assurance engagement is designed to obtain reasonable assurance about the Company's qualitative and quantitative compliance, in all material respects, with the Information Disclosure Determination, as amended and Input Methodologies Determination.

Quantitative materiality level was determined as 2% of total related party transactions. Qualitative factors were also considered when assessing the arm's length valuation rules on related party transactions.

The scope of our assurance engagement was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our assurance engagement, the nature, timing and extent of our assurance procedures and to evaluate the effect of misstatements, both individually and in aggregate on the related party information as a whole.

#### Key assumptions we made in carrying out our procedures

In carrying out our procedures as the independent appraiser for the disclosure year ended 31 March 2020, we have relied on the Company's internal controls relating to the identification of related party transactions and the valuation of related party transactions that we tested, and placed reliance on, during our audit of the financial statements for the year ended 31 March 2020.

#### How we sampled the Company's related party transactions

We obtained the Company's assessment of their compliance with the relevant related party valuation requirements in the Information Disclosure Determination, as amended and Input Methodologies Determination.

We selected a sample of related party transactions on a haphazard basis across a range of transactions and services, and agreed these to the supporting information provided by the Company to demonstrate the independent and objective measure used for those transactions and services, to determine whether it has been valued in accordance with the related party valuation requirements in the Information Disclosure Determination, as amended and Input Methodologies Determination.



## *Steps and analysis undertaken in testing compliance*

### **Step 1) Identifying related party relationships and transactions**

#### *Summary of steps undertaken by the Company to demonstrate compliance*

The Company identified all related party relationships in accordance with the Information Disclosure Determination, as amended, and disclosed these in Appendix A to the 2020 Information Disclosure Schedules as prepared and published under the Information Disclosure Determination, as amended.

During the year the majority of related party transactions occurred with NetCon Limited ('NCL') which is a 100% owned subsidiary of Alpine Energy Limited ('Alpine'). Small related party transactions also occurred with Alpine Energy shareholders – Timaru District Council, Waimate District Council and Mackenzie District Council. These transactions were deemed immaterial (\$70k) for the purposes of the Independent Appraiser report and mainly relates to council rates paid.

Related party transactions with NCL during the year ended 31 March 2020:

<b><i>Operating Expenditure (OPEX)</i></b>	<b><i>\$'000</i></b>
Service interruption and emergencies	2,415
Vegetation management	820
Routine & corrective maintenance	2,680
Asset replacement and renewal	295
System operations & network support	135
Total OPEX	<b>6,345</b>
<b><i>Capital Expenditure (CAPEX)</i></b>	
Consumer connection	2,940
System growth	277
Asset replacement and renewal	6,778
Asset relocations	238
Other reliability, safety and environment	328
Total CAPEX	<b>10,561</b>
<b><i>Total expenditure with NCL for 2020</i></b>	<b><i>16,906</i></b>



### *Our procedures undertaken*

We have tested the completeness and accuracy of the related party relationships and transactions by:

- Agreeing the disclosures within Appendix A and Schedule 5b of the 2020 Information Disclosure schedules to the audited financial statements for the year ended 31 March 2020 and to the accounting records, investigating any differences and determining whether any such differences are justified; and
- Applying our understanding of the business structure against the related party definition in the Input Methodologies Determination clause 1.1.4(2)(b) to assess Alpine’s identification of any “unregulated parts” of the entity.

### **Step 2) Outlining the background to the relationship with NCL**

#### *Summary of steps undertaken by the Company to demonstrate compliance*

Historically, Alpine and NCL worked under an Alliance Agreement, where work was issued to NCL as the primary contractor on the Alpine Network. In March 2019 a Master Services Agreement (‘MSA’) was signed with NCL. The MSA was put in place with the following objectives:

- Ensure NCL has sustainable volumes of work so that they commit sufficient local resources to efficiently deliver emergency and standby services required to support the network assets;
- Implement commercial incentive and dispute resolution processes to ensure pricing and commercial terms are competitive;
- Introduce contestability to ensure competitive tension amongst suppliers and provide sufficient flexibility to manage risks associated with delivering the services; and
- Involve other contractors through the broader, external tender market and through the process for new customer connections.

The MSA also allows Alpine to have greater visibility of the build-up of quoted prices provided by NCL, through the introduction of a mandatory Statement of Works (‘SOW’) for each quoted job.

Part of the policy intent of the new related party rules is to address concerns that related parties may be inefficient which may cause the Company to overcharge consumers. Alpine notes that the intent of the Alpine Group structure and establishment of NCL was to improve network reliability and secure qualified staff to efficiently maintain the network assets within the region. We understand that due to the location of the network and the lack of other contractors in the region, NCL continued to be the main service provider to Alpine.



#### *Our procedures undertaken*

- The background information provided by Alpine is in line with our understanding of the business and group.
- We obtained the Master Services Agreement and noted that the agreement was signed dated 29 March 2019, with the effective date being 31 March 2019 and is consistent with the understanding obtained from management.
- We note from our procedures performed that NCL continues to be the main service provider to Alpine with regards to CAPEX (80% of total expenditure) with limited examples of external providers used (with the exception of consumer connections).
- In relation to OPEX, we note that only 30% of the total expenditure is with NCL.

### **Step 3) Assessing compliance with the definition of an arm's length transaction (in accordance with ISA (NZ) 550)**

From 1 April 2018, a principles based approach to the valuation of related party transactions is being applied. All related party transactions must meet the arm's length valuation rule for ID disclosures, based on the following definition of arm's length transaction from the International Standard for Auditing (NZ) 550: *"a transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests".*

#### *Summary of steps undertaken by the Company to demonstrate compliance*

Alpine acknowledges that meeting the 'arm's length' valuation criteria, as defined above, is challenging due to the significant amount of work undertaken by NCL and limited use of other contractors for work on Alpine's network. In the current year, procurement of services from NCL was on the basis of provisions within the MSA.

To demonstrate compliance with the definition of arm's length, and specifically "willing buyer and seller" Alpine engaged an industry expert ('management's expert') to perform a benchmarking exercise on a sample of projects done by NCL during the year. The purpose of engaging an expert was to evidence that the prices quoted by NCL are not significantly different from the prices an unrelated contractor would have quoted. Management's expert benchmarked a sample of projects in the following expenditure categories:

- Asset replacement and renewal (OPEX and CAPEX);
- Asset relocation (CAPEX);
- Other reliability and safety (CAPEX); and
- System growth (CAPEX).



The expert also performed a review of the labour rates and hours which predominantly impacts the quotes for the following expenditure categories:

- Service interruption and emergencies (OPEX); and
- Routine & corrective maintenance (OPEX).

Management reviewed the report provided by Management's expert and provided reasons for each of the quotes where the expert determined the NCL price to be higher than an unrelated party would have quoted. Management also provided reasons why they deem NCL's labour rates to reflect rates between a willing buyer and seller.

Alpine's standard procurement process for consumer connections (CAPEX) is to obtain two quotes for each job and allow the customer to select the contractor and therefore an unrelated quote is always available to compare with the NCL quote.

Vegetation management (OPEX) is done by 2 contractors – NCL on the southern parts of the network and an unrelated contractor on the northern parts of the network. Alpine ensures that the quotes received from NCL is not significantly higher than those received from the third-party contractor.

#### *Our procedures undertaken*

NCL performed services in relation to 80% of Alpine's CAPEX (2019: 76%) and 30% of Alpine's total OPEX (2019: 28%) during the year ended 31 March 2020.

We have considered the following in our assessment over the arm's length definition:

#### *i. Terms and conditions*

The MSA sets out the terms and conditions for all services provided by NCL to Alpine. We reviewed the terms and conditions and noted that:

- In terms of clause 2.2 of the MSA, the MSA does not preclude Alpine from purchasing from any other third party or using its own resources to provide services similar to those it purchases from NCL;
- Clause 2.3 (c) states that one of the objectives of the MSA is to ensure that fair and competitive prices are quoted for work done for Alpine;
- The payment terms in clause 9 of the MSA is in line with that for external contractors.

#### *ii. Willing buyer and willing seller who are unrelated*

##### *Expenditure categories benchmarked by the management's expert:*

We obtained the reports from Management's expert and noted the expert concluded that, on average across all the CAPEX samples he benchmarked, NCL's quoted prices were 3% higher than the price an unrelated party would have quoted. We assessed management's response document which sets out the reasons for the higher quoted prices and why they deem it fair and reasonable. We concluded that based on all the evidence presented to us, the prices quoted by NCL was within an acceptable range to support the "willing buyer and seller" criteria of the definition.



Labour rates and labour productivity reviewed by management's expert for OPEX categories:

The report from Management's expert further indicated that NCL's labour rates are 5%-10% higher than he would expect for project and scheduled maintenance work. The reason for the higher rate is that NCL builds costs for additional services (i.e. 24/7 fault response, overtime, supplementary services etc.) into the standard labour rates. We further assessed management's response to why they deem the higher labour rates to be fair and reasonable. We concluded that based on all the evidence presented to us, the prices quoted by NCL was within an acceptable range to support the "willing buyer and seller" criteria of the definition.

Consumer connections:

Obtained copies of quotes from NCL and an unrelated contractor and for a sample of consumer connections and confirmed that

- two quotes were obtained;
- the contract was awarded to the contractor the customer selected.

Vegetation management:

Obtained a quote from the unrelated contractor Alpine uses for vegetation management on the northern part of the network and compared the hourly rates of that contractor to the hourly rate NCL for vegetation management. We noted that the unrelated contractor's rates and quotes were within an acceptable range of those of NCL.

*iii. Acting independently*

We note that Alpine and NCL have individual boards and executive management teams. In the prior year, these were only in place for part of the year. Even though NCL forms part of the Alpine Group, the Company is independently managed and operated.

*iv. Pursuing their own best interest*

We considered evidence obtained through our other procedures which indicates how each entity pursues its own best interest below:

*How does Alpine pursue its own best interests?*

- It reviews the statement of works received from NCL and, based on its experience, challenge any quotes it deems too high; and
- It engages NCL as main contractor because NCL has the most experience working on the Alpine network and due to the long-standing relationship, will always have resources available to provide the required services to Alpine.

*How does NCL pursue its own best interests?*

- It subcontracts work where this will result in a better outcome for the customer;
- It prepares a statement of work for each project to outline the resources required to fulfil the job requirements;
- It has overtime and 24/7 fault response built into its labour rates to ensure ongoing costs on projects are covered by initial quotes.



#### **Step 4) Obtaining independent and objective measures to support the arm's length principle**

##### *Summary of steps undertaken by the Company to demonstrate compliance*

As explained in step 3 above, management engaged an industry expert to perform benchmarking on specific expenditure categories and to review NCL's labour rates to demonstrate that prices paid to NCL are no more than arm's length transaction value.

To evidence that prices paid for consumer connections and vegetation management are not more than arm's length transaction value, Alpine has compared quotes obtained from NCL with those received from unrelated third-party contractors.

##### *Our procedures undertaken*

Our procedures were tailored based on the expenditure categories which align to the method management had applied to evidence that the transactions with NCL are at an arms' length. We have addressed our procedures on each of the categories below:

##### *Asset replacement and renewal (OPEX and CAPEX), asset relocation (CAPEX), other reliability and safety (CAPEX) and system growth (CAPEX) (\$7.916m):*

- Tested compliance with the procurement policy/process as disclosed in Appendix A to the Information Disclosure Schedules.
- Obtained the benchmarking report prepared by the management expert;
- Confirmed that the management expert's qualification and experience is adequate to perform the benchmarking;
- Confirmed that the management expert is independent from Alpine and NCL;
- Selected one sample and requested the management's expert to walk us through the process he followed to determine the benchmark price for the project, linking back the rate cards he used and the logic applied for each element that is used to build up the quote to ensure a logical process was followed which is consistent with how we would expect a benchmarking exercise to be performed.
- We selected a sample of the projects benchmarked by the management expert and performed the following procedures:
  - Obtained the management's experts underlying workings, broken into the individual components that make up the total quotes and agreed it to the value used in the report;
  - Obtained the NCL quote and agreed it to the quote price used in the management's expert's report;
  - Recalculated the difference between the quote and the benchmark,
  - Recalculated the percentage difference;
  - Reviewed the reasons provided by the expert and by management for why the NCL price is fair even if it exceeded the benchmark prices;
  - Determined if the difference between the quote and the benchmark are within an acceptable range.





Service interruption and emergencies and routine & corrective maintenance (\$5.095m):

- Tested compliance with the procurement policy/process as disclosed in Appendix A to the Information Disclosure Schedules.
- Obtained the report from the management's expert and reviewed the conclusions reached in respect of NCL's labour rates and hours.
- We further assessed management's response to why they deemed higher labour rates to be fair and reasonable. We concluded that based on all the evidence presented to us, the prices quoted by NCL was within an acceptable range to support the "willing buyer and seller" criteria of the definition.

Consumer connections (\$2.940m):

- Tested compliance with the procurement policy/process as disclosed in Appendix A to the Information Disclosure Schedules.
- Selected a sample and obtained the quotes received from NCL and the unrelated contractor.
- Verified that NCL was used based on approval by the customer of them being the preferred provider.

Vegetation management (\$820k):

- Tested compliance with the procurement policy/process as disclosed in Appendix A to the Information Disclosure Schedules.
- Obtained an invoice from the unrelated contractor who performed work on the northern parts of the network.
- Recalculated the cost per hour charged by the contractor.
- Obtained NCL's daily rates for network contractors, and specifically arborist.
- Compared the recalculated hourly rate of the unrelated third-party contractor to the hourly rate of NCL and determined that the NCL hourly rates are comparable.

We note that there was no specific testing performed on system operations & network support (OPEX). The total expenditure in this category is immaterial (\$135k).

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*Director's Responsibilities*

The Directors are responsible on behalf of the Company for:

- the identification of related-parties and related-party transactions during the disclosure year ended 31 March 2020;
- compliance with the Information Disclosure Determination, as amended and the valuation of related party transactions in accordance with the Information Disclosure Determination, as amended and the Input Methodologies Determination; and
- the identification of risks that threaten such compliance and controls which will mitigate those risks and monitor ongoing compliance.



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### *Appraisers' Responsibilities*

Our responsibility is to prepare an independent appraiser report in accordance with clause 2.8.4 of the Information Disclosure Determination, as amended. In preparing the report we are required to express an opinion on whether, for the disclosure year ended 31 March 2020, the basis for valuation of related party transactions complies, in all material respects, with the Information Disclosure Determination, as amended and the Input Methodologies Determination, and whether the steps taken by the Company to test whether it complies, are considered to be, in all material respects, reasonable in the circumstances.

Our engagement has been conducted in accordance with ISAE (NZ) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* and SAE 3100 (Revised) *Compliance Engagements* which require that we plan and perform our procedures to obtain reasonable assurance.

An assurance engagement to report on the Company's compliance with the Information Disclosure Determination, as amended and the Input Methodologies Determination involves performing procedures to obtain evidence about the compliance activity and controls implemented to meet the relevant related party valuation requirements of the Information Disclosure Determination, as amended and the Input Methodologies Determination. The procedures selected depend on our judgement, including the identification and assessment of risks of material non-compliance with the relevant related party valuation requirements of the Information Disclosure Determination, as amended and the Input Methodologies Determination.

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### *Independence and Quality Control*

When carrying out the engagement, we complied with:

- the Auditor-General's independence and other ethical requirements, which incorporate the independence and ethical requirements of Professional and Ethical Standard 1 (Revised) issued by the New Zealand Auditing and Assurance Standards Board;
- the independence requirements specified in the Information Disclosure Determination; and
- the Auditor-General's quality control requirements, which incorporate the quality control requirements of Professional and Ethical Standard 3 (Amended) issued by the New Zealand Auditing and Assurance Standards Board.

The Auditor-General, and his employees, and PricewaterhouseCoopers and its partners and employees may deal with the Company on normal terms within the ordinary course of trading activities of the Company. Other than any dealings on normal terms within the ordinary course of business, this engagement, regulatory compliance engagements and the annual audit of the Company's financial statements, we have no relationship with or interests in the Company. The provision of these other services has not impaired our independence as Appraiser of the Company.



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### *Inherent Limitations*

Because of the inherent limitations of an assurance engagement, together with the internal control structure it is possible that fraud, error, or non-compliance with compliance requirements may occur and not be detected.

A reasonable assurance engagement for the disclosure year ended 31 March 2020 does not provide assurance on whether compliance with the relevant related party valuation requirements of the Information Disclosure Determination, as amended and the Input Methodologies Determination will continue in the future.

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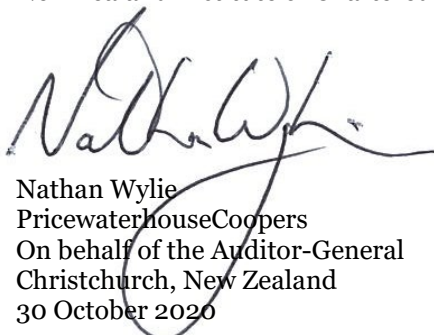
### *Use of this report*

This independent assurance report has been prepared solely for the Directors of the Company and for the Commerce Commission for the purpose of providing those parties with reasonable assurance on whether:

- the Company's related party transactions for the disclosure year ended 31 March 2020, comply, in all material respects, with clause 2.3.6 of the Information Disclosure Determination, as amended and clauses 2.2.11(1)(g) and 2.2.11(5) of the Input Methodologies Determination; and
- the steps taken by the Company, as specified under the "*Summary of steps and analysis undertaken by the Company to test compliance*" are considered to be, in all material respects, reasonable in the circumstances.

We disclaim any assumption of responsibility for any reliance on this report to any person other than the directors of the Company or the Commerce Commission, or for any other purpose than that for which it was prepared.

The engagement partner on the assurance engagement resulting in this independent appraiser's report is Nathan Wylie, who is a licensed auditor with the New Zealand Institute of Chartered Accountants which forms part of Chartered Accountants Australia and New Zealand.



Nathan Wylie  
PricewaterhouseCoopers  
On behalf of the Auditor-General  
Christchurch, New Zealand  
30 October 2020