

MR MARK TUME

**APPLICATION FOR EXEMPTION UNDER SECTION 81 OF THE ELECTRICITY
INDUSTRY REFORM ACT 1998**

Date: 9 June 2009

Applicant: Mr Mark Tume

Applicant's contact: c/- Chapman Tripp
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Application: Pursuant to section 81 of the Electricity Industry Reform Act, application is hereby made to the Commerce Commission for exemption from application of the EIRA.

Introduction

- 1 This application is made by Mr Mark Tume, who is currently a director of Infratil Limited, which owns a 50.5% shareholding in TrustPower.
- 2 Powerco Limited proposes to appoint Mr Tume to its board of directors.
- 3 It is not clear that the Electricity Industry Reform Act (*EIRA*), applies to Mr Tume's situation. On one reading of the EIRA, Mr Tume is not involved in electricity generation or retail through his directorship of Infratil. Mr Tume's proposed directorship of Powerco, which would see him "involved" in a line, would therefore not cause him to breach the EIRA.
- 4 However, the Commission has indicated that it takes an alternative interpretation of section 7(1)(b) of the EIRA (the definition of "involvement" in generation) which would see Mr Tume "involved" in generation, in addition to his anticipated involvement in a line.
- 5 This interpretation gives rise to internal inconsistencies in the EIRA and blurs the boundaries of EIRA for market participants. However, if the Commission elects to continue with this interpretation then Mr Tume seeks an exemption from the Commission from sections 17 and 17A of the EIRA, on the condition proposed below.

Infratil

- 6 Infratil Limited is a specialist investor in infrastructure and utility assets and is listed on the New Zealand Stock Exchange (NZX). One of Infratil's investments is a 50.5% shareholding in TrustPower, an electricity generator and retailer.

TrustPower

- 7 TrustPower is New Zealand's fourth largest electricity retailer, selling electricity throughout New Zealand. TrustPower's generation assets include hydro stations at Kaimai (a scheme of 4 stations) in the Bay of Plenty, and Patea, in South Taranaki, and a wind farm (Tararua) above Palmerston North.
- 8 The company is listed on the NZX and has three major shareholders, of which Infratil is the largest.

Powerco

- 9 Powerco is an electricity lines business, whose distribution network includes lines in the Tauranga and Taranaki regions.
- 10 TrustPower's Kaimai and Patea hydro stations, and the Tararua wind farm, are all embedded within Powerco's network and, as such, fall within Powerco's corresponding "local network areas", as defined in the EIRA.

Views as to application of the EIRA

- 11 Section 7 of the EIRA sets out the circumstances in which a person is deemed to be involved in electricity generation, an electricity line, or in selling electricity.

12 If Mr Tume was appointed a director of Powerco, the EIRA would deem him to be “involved” in a line. Directors are deemed to have a material influence over an electricity business (section 11), and material influence is sufficient to amount to involvement (section 7(1)(d)(iii)).

13 However, it is unclear whether Mr Tume also “involved” in generation under the EIRA.

Definition of “involvement”

14 Section 7 provides that a person is “involved”:

14.1 in generation if the person generates electricity from the generator, or owns or operates, directly or indirectly, the generator or any other assets used in connection with the generator, either alone or together with its associates and either on its own or another’s behalf (section 7(1)(b));

14.2 in selling electricity to a customer if the person sells to the customer either on its own or another’s behalf (section 7(1)(c)); or

14.3 in generation or retail if the person:

(i) carries on a business that does any of the things in (a) or (b) above (section 7(1)(d)(i));

(ii) holds more than 10% of the control rights or equity rights in a business that does any of those things (section 7(1)(d)(ii)); or

(iii) has “material influence” (defined in section 11 of the EIRA) over a business that does any of those things (section 7(1)(d)(iii)).

15 Whether Mr Tume can be said to be involved in generation depends on how Infratil is seen to be itself involved.

Infratil’s involvement in generation

16 Infratil is involved in generation through its 50.5% ownership of TrustPower, which exceeds the 10% threshold in section 8, as referred to in section 7(1)(d)(ii).

17 However, there is a question as to whether the primary route to involvement in generation – that is, section 7(1)(b) – applies to Infratil. In other words, does Infratil own or operate, directly or indirectly, the generation assets of TrustPower in the sense used in section 7(1)(b)?

18 The Commission has indicated that it reads “indirect ownership” as referring to ownership of electricity assets through shareholdings. In Decision 618, a decision made prior to the most recent amendments to EIRA, the Commission suggested shareholdings in related companies amount to that indirect ownership. In that case,

the question was not determinative, as Vector exceeded the 10% ownership threshold.

- 19 On this expansive approach to “indirectly”, as a majority shareholder, Infratil indirectly owns the generation assets of TrustPower.
- 20 While there is a temptation to read “indirectly” in section 7(1)(b) as capturing shareholdings in companies that generate electricity, this is not consistent with the rest of the Act. In particular:
- 20.1 if section 7(1)(b) is read as capturing shareholders, then this renders section 7(1)(d)(ii) redundant. Section 7(1)(d)(ii) has been specifically included to catch shareholders with a shareholding of greater than 10%. Reading section 7(1)(b) as addressing shareholders renders this redundant, and undermines the explicit policy choice of setting a 10% threshold. The approach indicated in Decision 618 leaves hanging the question what level of shareholding is now sufficient to trigger “indirect ownership” under section 7(1)(b)?
- 20.2 if section 7(1)(b) is read as capturing shareholders, then generation will be treated differently from retail. As discussed below, this is illustrated by Mr Tume’s situation. An expansive reading of section 7(1)(b) would mean that Mr Tume is treated as involved in TrustPower’s generation, but not involved in TrustPower’s retail. There is no reason for creating such a distinction.
- 21 The better view is that the directly or indirectly language in section 7(1)(d)(ii) is there to close loopholes at the TrustPower level. An example would be where TrustPower held the beneficial but not legal title to the generation assets.
- 22 However, it is plain that shareholding links were intended to be addressed under section 7(1)(d)(ii).
- 23 For these reasons the better view is that Infratil is involved by virtue of section 7(1)(d)(ii), and not by virtue of section 7(1)(b). As discussed below this would mean Mr Tume is not caught by section 7(1)(d).

Mr Tume’s involvement

Generation

- 24 Whether Mr Tume is “involved” in generation turns on which of the above interpretations is applied.
- 25 If Infratil is involved in generation only by virtue of exceeding the 10% ownership threshold, Mr Tume is not involved in generation under section 7. By virtue of his directorship he is treated as having a material influence over Infratil, but for the purposes of section 7(1)(d)(ii) Infratil is not a business that does any of “those things” (i.e. the activities in section 7(1)(a) to (c)). Mr Tume would only be involved in generation if he had material influence (as defined in section 11) over TrustPower. None of the elements in section 11 apply to Mr Tume.

26 However, if section 7(1)(b) was read in a way which treated Infratil as involved in generation, through an “indirect” ownership of TrustPower’s generation assets, Mr Tume will be deemed to be also involved in that generation, through his directorship of Infratil (giving him material influence over a business to which section 7(1)(b) applied).

Retail

27 The issue does not arise when assessing whether Mr Tume is involved in electricity retail.

28 The definition of “involvement” with respect to selling electricity (section 7(1)(c)) does not refer to ownership (either direct or indirect) of assets used in selling electricity. This means the issue discussed in relation to generation, above, does not arise.

29 In this case, it is clear that Infratil is only itself involved in selling electricity by exceeding the 10% ownership threshold in respect of its TrustPower shareholding. Infratil is not a business that does any of “those things” in section 7(1)(c), and so Mr Tume’s directorship does not trigger section 7(1)(d)(iii). Further, Mr Tume does not have material influence over TrustPower (as defined in section 11) and is, therefore, not “involved” in selling electricity through his directorship of Infratil.

30 The result is that the interpretation issue discussed above determines whether Mr Tume is to be treated as involved in generation, but under any approach Mr Tume is not involved in retail. If anything, this highlights why taking an expansive approach to “indirectly” in section 7(1)(b) distorts the statutory scheme. There is no indication that the Act is intended to cast the net more widely for generation than for retail.

31 These points are raised because they are of practical importance. The approach suggested in Decision 618 (but not relied on) removes the clarity around the size of shareholding that triggers involvement under EIRA, significantly reducing certainty for market participants. It also treats retail and generation differently. However, if this is the Commission’s preferred interpretation then jurisdiction is not contested and this application is made on that basis.

Connected generation cap

32 If Mr Tume was “involved” in both TrustPower’s hydro and wind generation and Powerco’s lines, he would be involved in “connected generation”, as the Kaimai and Patea hydro stations, and the Tararua wind farm, fall within Powerco’s local network areas.

33 Section 17A sets out the connected generation cap thresholds. Both hydro schemes have a capacity greater than 5 MW and were commissioned before 20 May 2003, which fall outside the thresholds in section 17A.

34 As a consequence, if Mr Tume is appointed to the Powerco board without an exemption, he would be in breach of the connected generation cap. His impending involvement in connected generation will thus contravene the ownership restriction in section 17.

Corporate separation and arm's length rules

35 An involvement in more than 10 MW of connected generation requires the corporate separation and arm's length rules to be complied with (section 17D). These requirements will apply from the date of Mr Tume's appointment to the Powerco board.

Corporate separation already exists

36 The corporate separation rule requires the "connected electricity businesses", in this case Powerco and TrustPower (the businesses in which Mr Tume is "involved"), to be carried out in separate companies.

37 This requirement is already met. TrustPower and Powerco are separate and independent companies. For completeness, Infratil and Powerco are also separate and independent companies.

Arm's length rules already met

38 Powerco and TrustPower already comply with the arm's length rules, and this position would not be affected by Mr Tume's appointment to the Powerco board. No cross directorships would exist between Powerco and TrustPower. While Mr Tume would be a cross director on the boards of both Powerco and Infratil, he is not an executive director (Rule 8). Thus the arms length rules are also met as between Powerco and Infratil.

Analysis in relation to the Commerce Commission's three primary criteria

39 The Commission's exemption application guidelines state that the Commission will consider three primary questions in considering applications for exemption under section 81 of the EIRA. Analysis in relation to each of these questions is set out below.

Would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between an electricity lines business and electricity supply business which is not at arm's length?

40 No. As explained above, the arm's length rules would be met between Powerco and TrustPower and Powerco and Infratil.

Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to inhibit competition in the electricity industry?

41 No practical opportunities or incentives to inhibit competition would arise from the appointment of Mr Tume to the Powerco board.

- 42 As a director of Infratil, Mr Tume is bound by a duty, under the Companies Act 1993, to make decisions in the best interests of Infratil. He would be under the same duty in respect of Powerco.
- 43 Mr Tume is only one director on the Infratil board, which has a majority of independent directors and, in any event, does not address matters relating to the operational details of TrustPower's business, such as TrustPower's agreements with electricity distribution companies.
- 44 Powerco will require Mr Tume to not participate in discussions, or voting, on matters relating to TrustPower. This restriction could be a condition of the exemption sought by Mr Tume, as discussed further below.

Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses?

- 45 The Commission has previously taken the view (Decisions 517 and 629) that there exists a potential mechanism whereby an electricity lines business could be used to cross-subsidise a generator's generation activities. This could occur through the terms of a use of system agreement negotiated between the electricity distributor and the generator, which did not provide a commercial return to the distributor, and the opportunity for the negotiation of such an agreement could be influenced by the presence of a cross-involved person.
- 46 Powerco and TrustPower have existing agreements relating to TrustPower's connected generation. These agreements are not due to expire in the near future. Powerco is unaware of any further TrustPower generation project that would connect to Powerco's network. Due to Powerco's requirement that Mr Tume absent himself from voting and discussion on TrustPower matters, Mr Tume will not be in a position to influence these agreements in any way.
- 47 Further, Powerco's electricity lines are subject to price control and information disclosure requirements under Part 4 of the Commerce Act. Even on the unrealistic assumption that Powerco was willing to attempt to cross-subsidise TrustPower's generation activities once Mr Tume was appointed to the Powerco board, the Part 4 regulatory regime means that Powerco would have minimal, if any, opportunity to do so.
- 48 From a distribution/retail perspective, the companies are subject to use-of-systems agreements with respect to Powerco's supply of lines services to TrustPower. The only possible amendment Powerco envisages to these agreements is changes to reflect any model use-of-system agreement mandated by the Electricity Commission.
- 49 As with Powerco and TrustPower's connected generation agreements, due to Powerco's requirement that Mr Tume absent himself from voting and discussion on TrustPower matters, Mr Tume will not be in a position to amend the use-of-system

agreements in such a way that Powerco did not earn a commercial return on this supply, or TrustPower was favoured relative to other retailers. In fact, Powerco has previously committed to charge the same price to all retailers to which it supplies electricity.

50 To the extent that the Commission remains concerned that Mr Tume's appointment may give rise to any opportunities or incentives to inhibit competition or lead to cross-subsidisation of TrustPower's generation, the Commission could grant an exemption on the following condition:

50.1 while Mark Tume is involved in "connected generation", through his directorships of Infratil Limited and Powerco Limited, Mark Tume shall not participate in any discussions or decision making by Powerco Limited regarding matters that relate to or could affect:

- (a) the supply of connected generation by TrustPower Limited to Powerco Limited; or
- (b) the supply or favour provision of electricity lines services by Powerco Limited to TrustPower Limited.

Attachments

51 Attached in support of this application is a Declaration, in the prescribed form, by Mr Tume as applicant.

Fees

52 Attached is a cheque for \$11,250.00 for fees prescribed for exemption applications under the Electricity Industry Reform Act (Fees) Regulations 1998. Please advise the applicant's contacts (Chapman Tripp) of the actual cost of processing this application and the amount of refund as soon as practicable.

Discussion

53 Chapman Tripp would be happy to discuss any aspect of this application with the Commission.

DECLARATION

THIS APPLICATION is made by **Mark Tume**.

Mark Tume confirms that:

- all information requested by the Commerce Commission has been supplied;
- all information known to the applicant which is relevant to the consideration of this application has been supplied to the Commerce Commission; and
- all information supplied by the applicant to the Commerce Commission is correct as at the date of this application.

Mark Tume undertakes to advise the Commerce Commission immediately of any material change in circumstances relating to the application.

Dated this 9th day of June 2009

Signed by: Mark Tume


