

**BABCOCK AND BROWN INFRASTRUCTURE LIMITED**

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

**Date:** 30 August 2007

**Applicant:** Babcock & Brown Infrastructure Limited  
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**Application:** Pursuant to section 81 of the Electricity Industry Reform Act 1998 (*EIRA*), application is hereby made to the Commerce Commission for exemption from the application of the EIRA.

## **Applicant**

- 1 The applicant is Babcock & Brown Infrastructure (*BBI*), a stapled entity listed on the ASX and the NZX, and comprised of Babcock & Brown Infrastructure Limited and Babcock & Brown Infrastructure Trust. BBI is a specialist infrastructure entity which provides investors access to a diversified portfolio of quality infrastructure assets. BBI has investments in energy distribution and transport infrastructure assets in Australia, Europe and North America.
- 2 BBI owns 100% of BBI Networks (New Zealand) Limited (*BBI NZ*). BBI NZ is the owner of Powerco, New Zealand's second largest electricity and gas distribution business. BBI is therefore a lines business for the purposes of the EIRA.
- 3 BBI is widely held. Babcock & Brown International Pty Ltd (*B&B*), a global investment and advisory firm whose parent entity Babcock & Brown Limited is listed on the ASX, has a small ownership interest of around 8.2% in BBI.
- 4 BBI seeks an exemption for its incidental and temporary ownership interest in Glenbrook Power Station (*Glenbrook*).

## **Glenbrook power station**

- 5 Glenbrook is a 112 MW cogeneration power plant, comprising the Kilns Cogeneration Plant, which came online in 1997, and the Multi-Hearth Furnace Cogeneration Plant, which was commissioned in 1987. It is the main supplier of electricity and steam to New Zealand Steel for use in the Glenbrook steelworks.
- 6 As discussed in detail below, Glenbrook will soon be fully owned by Babcock & Brown Power (*BBP*).
- 7 Glenbrook's Kilns plant is technically connected to the national grid through New Zealand Steel's connection arrangements with Transpower. However, Glenbrook does not export any electricity to the national grid. The MHF plant is integrated into the steelworks' electricity reticulation system.
- 8 Glenbrook is fully integrated with the steelworks. Both plants rely on "off gases" from the steelmaking process as their fuel source. The output of Glenbrook is therefore dependent on the level of the production processes at the steelworks for the various gases that are used to fuel the generation units. The Glenbrook plant cannot be operated independent of the steelworks.
- 9 All output is contracted to, and used by, the steelworks. Glenbrook currently supplies approximately 60% of the electricity requirements of the steelworks, with New Zealand Steel currently supplementing the power it

receives from Glenbrook with power purchased from the national electricity market. Glenbrook has no ability to influence power prices in this market.

- 10 For these reasons, while Glenbrook meets the technical definition of an electricity supply business in the EIRA, it is highly unlikely to give rise to the concerns that the EIRA addresses.

**BBP**

- 11 BBP, listed on the ASX, is a specialist infrastructure entity which provides investors access to an electricity generation portfolio.

**BBI's incidental and temporary ownership of Glenbrook**

- 12 A consortium formed by B&B, Singapore Power International Pte Limited, BBI, BBP and Babcock & Brown Wind Partners is due to acquire the assets of Alinta Limited (*Alinta*), which is also listed on the ASX, on 31 August 2007. Alinta owns a very wide variety of assets, which will be split between the consortium members.
- 13 The consortium is using a special purpose company, ES&L Pty Limited (*ES&L*), as a bidding vehicle to undertake the acquisition of Alinta. BBI ultimately holds 99.9% of ES&L.
- 14 The acquisition involves a complex process which includes a series of transaction steps. As part of this process ES&L, via a Scheme of Arrangement, will acquire all the shares in Alinta. This means that the various Alinta assets will be held temporarily by BBI/ES&L from 1 September 2007, before being transferred to the various consortium participants.
- 15 As part of the acquisition, BBP has agreed to acquire the Alinta power generation portfolio, which includes Glenbrook. The assets BBI proposes to acquire from Alinta are limited to interests in Australian gas pipelines and an asset management business operating gas pipelines in Western Australia. Notwithstanding this, the effect of the transaction process means that BBI will temporarily be "involved" in an electricity supply business until Glenbrook is transferred to BBP.
- 16 The holding arrangements will remain in place only until ES&L obtains certain Glenbrook counter party consents and completes certain other pre-requisite restructuring steps.
- 17 It is difficult for BBI to give a precise indication as to the likely duration of the holding arrangements, as this depends on the ease of obtaining the necessary consents and effecting the other restructuring steps in the transaction process. However, BBI believes that a time frame of four weeks is realistic and therefore seeks an exemption for that period of time.

### **Ring fencing arrangements**

- 18 During the period that BBI will nominally hold Glenbrook, contractual arrangements in place between members of the consortium will ensure it will have no power over the economic and operational control of Glenbrook. These arrangements are designed to ensure that each consortium member maintains control of and bears all financial and economic risks of the assets ultimately destined for that consortium member during the period of ES&L ownership.
- 19 The arrangements are effected through loan notes issued by ES&L to each consortium member, such as BBP. Each individual asset (such as Glenbrook) will be the subject of a separate loan note. Each holder of a loan note will have the exclusive right and responsibility to manage the applicable Alinta asset, including the funds flowing into and from that asset, until the asset is transferred to it. The arrangements also provide that immediately upon the acquisition of Alinta shares by ES&L, BBP (not BBI) will nominate directors to the Glenbrook Board.
- 20 BBI will have no rights under the consortium arrangements to access any information relating to Glenbrook. BBI will also have in place ring fencing arrangements to ensure that it has no access to Glenbrook information. They have been put in place for commercial reasons, as BBP has an interest in BBI not having access to Glenbrook information.
- 21 BBI proposes the following ring fencing arrangements as a condition to any exemption granted in respect of this application:
- 21.1 no common officers or employees of BBI and the companies with direct ownership of the Glenbrook assets;
  - 21.2 no information relating to the day to day operation of Glenbrook disclosed to any officers or employees of BBI; and
  - 21.3 no officer or employee of BBI involved in decisions relating to the management of Glenbrook.

### **Independent nature of BBI and BBP**

- 22 BBI and BBP, the long term owner of Glenbrook, are not associated.
- 23 The only link between the two is a common shareholder: B&B. As discussed above, B&B has an 8.2% shareholding in BBI. It also holds 7.4% of the stapled securities of Babcock & Brown Power Limited and Babcock & Brown Power Trust which together comprise BBP.

### **Application of the EIRA**

- 24 Section 17 of the EIRA prohibits the cross involvement between electricity lines and electricity supply businesses.
- 25 Section 5(1) of the EIRA provides that:
- (1) For the purposes of this Act, **electricity supply business**—
- (a) Means a business that—
- (i) Sells electricity in New Zealand:
  - (ii) Sells financial hedges for risks relating to the price of electricity in New Zealand:
  - (iii) Generates electricity in New Zealand:
  - (iv) Trades in rights to sell or generate electricity in New Zealand; and
- (b) Includes the ownership or operation, directly or indirectly, of a generator in New Zealand or any other core generation assets; and
- (c) Includes the ownership or operation, directly or indirectly, of any core assets of an electricity retail business, which include—
- (i) The customer data base relating to and used for the purposes of an electricity retail or electricity trading business; and
  - (ii) The benefit of a contract to sell electricity; and
  - (iii) The benefit of an undertaking from any other electricity supply business not to compete with the business.
- 26 Glenbrook is an electricity supply business under the EIRA.
- 27 Section 4 of the EIRA provides that:
- (1) For the purposes of this Act, **electricity lines business**—
- (a) Means a business that conveys electricity by line in New Zealand; and
  - (b) Includes the ownership or operation, directly or indirectly, of lines in New Zealand or any other core assets of an electricity lines business.
- (2) None of the following activities brings a person within subsection (1):

- (a) Conveying, together with its associates (if any), less than 2.5 GWh per annum: ....

28 BBI is an electricity lines business under section 4 of the EIRA by virtue of its 100% ownership in Powerco, through BBI NZ, and is therefore cross involved under section 17 of the EIRA.

**Exemption sought**

29 Section 81 of the EIRA provides that the Commission may exempt any business, involvement or interest from the application of the EIRA, or any person or class of persons from compliance with any provisions of the EIRA.

30 BBI seeks a four week exemption from section 17 of the EIRA in relation to its temporary ownership of Glenbrook, on the conditions specified in paragraph 21.

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

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

32 BBI submits that there will be no opportunity to inhibit competition.

33 BBI's temporary ownership of Glenbrook will arise incidentally in the context of a large and complex transaction process. Furthermore, as outlined above, BBI will not have the ability to exercise any control over Glenbrook by virtue of this incidental ownership. BBP will have the exclusive right and responsibility to manage Glenbrook until it formally takes ownership.

34 Importantly, the ownership interest of BBI will be temporary – a matter of weeks, depending on the ease of obtaining the necessary third party consents and effecting the other restructuring steps in the transaction process.

35 Equally, there will be no incentives to inhibit competition. BBI has no economic interest in Glenbrook or BBP, nor does it have any control over Glenbrook's finances.

***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?***

- 36 As stated above, BBI will have no economic interest in Glenbrook. All profits will flow to BBP.

***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 arms length?***

- 37 In Decision 541, the Commission acknowledged that compliance with the arms length rules is not always strictly necessary, stating at paragraph 76:

*In most circumstances where an exemption is required from the ownership separation rules a relationship will be created that will ultimately not be at arms' length.*

- 38 The Commission then stated that its approach in such cases is to assess the practical effect of the non-arms length relationship in order to decide whether that relationship is likely to lead to a result that would be contrary to the purposes of the EIRA.

- 39 BBI submits its cross involvement will be a technical and temporary one. It will not derogate from the overall purpose of the EIRA to ensure that costs and prices are subject to sustained downward pressure, and that the benefits of efficient electricity pricing flow through to all classes of consumers.

**Further information**

- 40 Please contact either Chapman Tripp or BBI if any further information is required in relation to this application.

## DECLARATION

**THIS APPLICATION** is made by **Babcock & Brown Infrastructure Limited**

The company hereby confirms that:

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

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

Date: 2007

Signed by:

*Acting Chief Executive Officer*

I am an Officer of the company and am duly authorised to make this application.