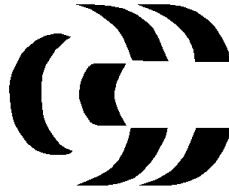


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COMMERCE COMMISSION

Decision No. 349

Determination pursuant to the Electricity Industry Reform Act 1998 (the EIR Act), in the matter of an application for exemption of an involvement in an electricity lines business and an electricity supply business from the application of the EIR Act. The application is made by:

TOP ENERGY LTD

The Commission:

K M Brown
E C A Harrison
P R Rebstock

Commission Staff:

D R Ainsworth
A J Brice

**Summary of
Application:**

Top Energy Ltd, which is involved in an electricity lines business and an electricity supply business, seeks an exemption, pursuant to section 81 of the EIR Act from the application of the EIR Act (Part A of the application) and to extend the time available to it under the EIR Act to retain the option of establishing a mirror trust (Part B of the application). This Decision addresses Part B of the application.

Determination:

The Commission, pursuant to section 81 of the EIR Act, exempts Top Energy Ltd from the application of section 38(1)(c) and section 39 of the EIR Act in relation to the mirror trust option. The exemption is subject to the conditions stated in this Decision.

Date of Determination:

26 March 1999

Date of Exemption:

On publication of the Notice of Exemption in the *Gazette*

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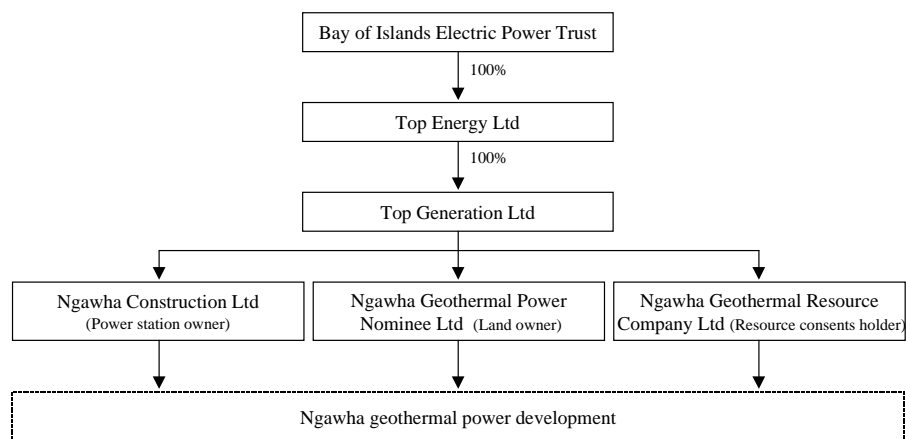
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INTRODUCTION

- 1 On 11 March 1999, the Commerce Commission (the Commission) received an application from Top Energy Ltd (Top Energy) for exemption from the application of the EIR Act.
- 2 The Commission's powers to exempt businesses, involvements or interests from the application of the EIR Act or persons from compliance with any provisions of any regulations made under the EIR Act are specified in section 81 of the EIR Act.

TOP ENERGY LTD

- 3 Top Energy is an electricity lines business formed under the Energy Companies Act 1992 and operating in the area covered approximately by the Far North District Council. Top Energy supplies line function services to about 24,500 customers who consume approximately 280 GWh¹ of electricity per annum.
- 4 On 14 December 1998, Top Energy settled a Supply Business Sale Agreement with Contact Energy Ltd (Contact) under which Contact purchased Top Energy's electricity supply business.
- 5 Top Energy is owned by a community trust, the Bay of Islands Electric Power Trust.
- 6 Top Energy has an interest in a generation asset, the Ngawha geothermal power station (Ngawha power station). This interest was not part of the Supply Business Sale Agreement with Contact. Top Energy's interest in the Ngawha power station is held through a wholly owned subsidiary, Top Generation Ltd, and in turn through further subsidiary companies.



Subsidiary	Function	Holding
Top Generation Ltd	Holds investment in the joint venture	100%
Ngawha Construction Ltd	Power station owner	[]
Ngawha Geothermal Power Nominee Ltd	Holder of the land	[]
Ngawha Geothermal Resource Company Ltd	Holder of the resource consents	[]

¹ Less than 2% of electricity distributed in the national electricity retail market.

7 [

]

8 The Ngawha power station, situated at Ngawha Springs road, Ngawha² consists of two generating units with a combined nameplate capacity of 9 MW.³ The Ngawha power station was commissioned in July 1998 and, while currently generating at a slightly lower level, is expected to generate approximately 70 GWh of electricity per annum.

9 Top Energy has entered into an Agreement for the Sale and Purchase of Electricity relating to the Ngawha Geothermal Generation Facility (Electricity Sale and Purchase Agreement) with Contact. This agreement was settled on the same day as the Supply Business Sale Agreement with Contact. The Electricity Sale and Purchase Agreement requires Contact to take all electricity generated by the Ngawha power station for a period of three years, or, if extended, five years. Contact is required to pay [

]

INVOLVEMENTS

Electricity Lines Business

- 10 Top Energy is the owner of a network. In terms of the EIR Act it:
- owns a business that conveys electricity by line in New Zealand (s4(1)(a));
 - owns and operates, directly, lines in New Zealand and other core assets of an electricity lines business (s4(1)(b)); and
 - has no activities excluded from the definition of an electricity lines business by section 4(2).
- 11 Top Energy:
- carries on an electricity lines business alone or together with associates (s7(1)(a));
 - exceeds the 10% threshold in terms of control and equity return rights in that business (s7(1)(b)); and
 - has material influence over that business (s7(1)(c)).
- 12 Therefore Top Energy is involved in an electricity lines business in terms of the EIR Act. Top Energy agrees with this interpretation in its application for exemption.

Electricity Supply Business

- 13 Top Energy in terms of the EIR Act:
- sells electricity in New Zealand (s5(1)(a)(i));
 - owns and operates directly a generator in New Zealand;

² Legally described in Appendix 2 of the Top Energy application.

³ Confirmed by Top Energy.

- has no other activities excluded from the definition of an electricity supply business by section 5(2).
- 14 Top Energy:
- carries on an electricity supply business alone or together with associates (s7(1)(a));
 - exceeds the 10% threshold in terms of control rights or equity return rights in that business (s7(1)(b)); and
 - has material influence over that business (s7(1)(c)).
- 15 Therefore, Top Energy is also involved in an electricity supply business in terms of the EIR Act. Top Energy agrees with this interpretation in its application for exemption.

PROHIBITED CROSS-INVOLVEMENT

- 16 Section 17 provides:
- “(1) No person involved in an electricity lines business may be involved in an electricity supply business.
 - (2) No person involved in an electricity supply business may be involved in an electricity lines business.”
- 17 Top Energy is involved, and wishes to remain involved, in both an electricity lines and an electricity supply business. Top Energy will, after 1 April 1999, have a prohibited cross-involvement, in terms of section 17 of the EIR Act.

MIRROR TRUSTS

- 18 Sections 37 to 45 of the EIR Act provide an exemption in certain respects for an electricity trust which has a cross-involvement, from the EIR Act’s ownership separation rules where a mirror trust is established. The mirror trust exemption is only available to an existing customer or community trust which had a cross-involvement at 23 June 1998. The mirror trust option must be exercised by 1 April 1999.
- 19 Section 38(1) provides:
- “(1) A settling trust may use the mirror trust option if—
 - (a) The settling trust is an existing trust that has a cross-involvement in an electricity business as at 23 June 1998; and
 - (b) The settling trust is either of or both a customer or community trust; and
 - (c) The mirror trust is established by 1 April 1999.”
- 20 Section 39 provides:
- “(1) By 1 April 1999, the mirror trust, or any company in which the mirror trust is or will be involved, must have entered into a binding written contract to acquire all or part of the interests in or assets of the electricity lines business or electricity supply business from the settling trust or any company in which the settling trust is involved.
 - (2) By 1 April 1999, under that contract,—
 - (a) The risks of owning or having the involvement must have substantially passed to the buyer; and
 - (b) The price to be paid by the buyer must be a dollar amount that is certain at the date of the contract.

(3) As from 1 April 1999, business A must be carried on by the mirror trust or any company in which the mirror trust is involved, and not by the settling trust or any company in which the settling trust is involved.

(4) By 1 April 2000, the contract referred to in subsection (1) must have been completed.”

- 21 Top Energy, as an existing community trust which had a cross-involvement at 23 June 1998, thus has until 1 April 1999 to exercise the mirror trust option if it so wishes.

THE EXEMPTION APPLICATION

- 22 Top Energy has submitted a two-part application for exemption:

- **Part A** seeks exemption from the application of section 17 of the EIR Act in relation to its interest in the Ngawha power station; and
- **Part B** seeks exemption from the requirement to implement a mirror trust prior to 1 April 1999, as required under section 38 and section 39 of the EIR Act, from 1 April 1999 until three months after the day of the Commission’s decision on Top Energy’s Part A application (three month extension).

- 23 This Decision deals solely with **Part B** of Top Energy’s application. Top Energy has sought urgency from the Commission in consideration of its Part B application, and has requested a decision by 24 March 1999.

COMMISSION PROCEDURES

General

- 24 For the purpose of considering this application, the Commission, pursuant to section 58 of the EIR Act which applies section 105 of the Commerce Act 1986 to the EIR Act, has delegated its powers under section 81 of the EIR Act to K M Brown, E C A Harrison, and P R Rebstock.
- 25 The Commission’s decision is based on an investigation conducted by its staff and their subsequent advice to the Commission.

Criteria Used by the Commission to Consider Exemption Applications

- 26 The EIR Act gives the Commission wide powers of enforcement, extension and exemption. To provide assistance to parties affected by the EIR Act, the Commission set out its role and processes in Practice Note No.3.⁴
- 27 The Commission stated in Practice Note No.3 that:
- “The EIR Act provides for the Commission to make exemptions in terms of section 81 of the EIR Act. In considering applications for exemptions, the Commission will have specific regard to the particular purpose of Parts 1 to 5 of the EIR Act as defined in section 2(2) of the EIR Act. The Commission is likely to grant an exemption in respect of a business or involvement or interest only where doing so:

- (a) would not result in certain involvements in electricity lines businesses and electricity supply businesses which may create incentives or opportunities:
 - (i) to inhibit competition in the electricity industry; or

⁴ Practice Note No.3, September 1998, Electricity Industry Reform Act 1998 Commission’s Role and Processes.

- (ii) to cross-subsidise generation activities from electricity lines businesses; and
- (b) would not result in relationships between electricity lines businesses and electricity supply businesses which are not at arms length.

In determining exemptions, the Commission will also have regard to the overall purpose of the EIR Act as set out in section 2(1) of the EIR Act. That is, to reform the electricity industry to better ensure that:

- (a) costs and prices in the electricity industry are subject to sustained downward pressure; and
 - (b) the benefits of efficient electricity pricing flow through to all classes of consumers
- by –
- (c) effectively separating electricity distribution from generation and retail; and
 - (d) promoting effective competition in electricity generation and retail.”

28 The Commission noted in Practice Note No.3 that:

“the EIR Act provides for maximum cross-ownership limits and specific structural and behavioural requirements to ensure that the purposes of the EIR Act are met. Strict compliance with these limits and requirements is, other than in exceptional circumstances,⁽⁵⁾ expected.”

29 The Commission stated in Practice Note No.3 that:

“On receipt of an application the Commission will determine whether granting an exemption would be contrary to any element of the particular purpose of Parts 1 to 5 of the EIR Act or the overall purpose of the EIR Act.

The Commission’s tests would necessitate obtaining and evaluating objective answers to the following three questions in relation to the particular purpose of Parts 1 to 5 of the EIR Act:

- 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?;
- 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?; and
- 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 an electricity supply business which is not at arms length?

In relation to these questions, the Commission will consider factors such as:

- Relevant markets within the electricity industry;
- The nature of any incentives or opportunities created;
- The temporal nature of any incentives or opportunities created;
- The nature of any relationship which is not at arms length; and
- The temporal nature of any relationship which is not at arms length.”

RELEVANT MARKET

34 The national electricity generation market appears relevant to the application of the Commission’s criteria to the facts of Top Energy’s Part B application for exemption.⁶

⁵ For example, of the types provided for in section 19 of the EIR Act.

⁶ Other markets in the electricity industry, for example the wholesale electricity market, the electrical construction and maintenance market, the market for the reticulation of new subdivisions, the local distribution market, and the national electricity retail market, do not appear to be relevant to this application for exemption.

TOP ENERGY'S ARGUMENTS

- 30 If Top Energy's Part A application proves unsuccessful, it would be in breach of the EIR Act's ownership separation rules from 1 April 1999 and would no longer have the option of creating a mirror trust. Top Energy has argued that statutory and legal considerations mean that it is likely three months would be required to put in place a mirror trust. If Top Energy's Part A application proves unsuccessful, it has stated it will put in place a mirror trust. Therefore, it seeks a three month exemption to prevent it from being in breach of the EIR Act while putting in place the mirror trust.
- 31 Top Energy states it has delayed making its Part A application until March for three reasons:
- it was awaiting release of the Commission's first EIR Act decisions which were not released until early February;
 - Top Energy []
]; and
 - Top Energy recognised that the Commission was considering clearance applications for Contact and that, given the statutory priority of clearances, its application was unlikely to be processed at any earlier time.
- 32 Top Energy has argued that because it is seeking a short-term exemption, the exemption:
- would not create incentives or opportunities to inhibit competition in any electricity market;
 - would not create incentives or opportunities to cross-subsidise generation activities from its electricity lines business; and
 - would not permit a relationship between an electricity lines business and an electricity supply business which is not at arms length.

EXAMINATION IN TERMS OF THE COMMISSION'S CRITERIA

Incentives Or Opportunities To Inhibit Competition in the Electricity Industry

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?

- 33 The potential output from the Ngawha power station is negligible in terms of the national electricity generation market:
1. At 9.0 MW \approx 0.19% of the national electricity generation market
 2. At 9.0 MW \approx 29.00% of regional electricity consumption
- 34 Competition in the national electricity generation market is likely to increase as a result of the split of the Electricity Corporation of New Zealand Ltd (ECNZ) into three competing generators, coupled with the existence of other significant generators including Contact, TransAlta New Zealand Ltd, and TrustPower Ltd.

- 35 Top Energy's Electricity Sale and Purchase Agreement with Contact requires Contact to purchase all electricity generated at the Ngawha power station [] for, at least, the next three years.
- 36 Top Energy is not able to alter the terms or conditions of the Electricity Sale and Purchase Agreement during the three month extension.
- 37 Top Energy's use-of-system agreement with Contact includes electricity supply to domestic consumers. The use-of-system agreement is in place and could not be materially modified during the three month extension.
- 38 No other electricity retailer has a use-of-system agreement with Top Energy⁷ which covers domestic consumers. Top Energy has stated that it would negotiate similar use-of-system agreements if approached for such an agreement by other electricity retailers. It is unlikely that the three month extension would impact upon any such approach or subsequent negotiation.
- 39 The Commission considers an effective extension of the date until which Top Energy would retain the option to establish a mirror trust may create incentives or opportunities for Top Energy to inhibit competition in the national electricity generation market, but that these would not be more than minimal.

Incentives or Opportunities to Cross-subsidise Generation Activities

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?

- 40 The Commission considers that incentives or opportunities to cross-subsidise generation activities from electricity lines business are potentially present whenever cross-involvements exist. In this instance, incentives or opportunities to cross-subsidise generation activities from the electricity lines business could be created. Namely:
- the incentive or opportunity to offer favourable connection terms;
 - the incentive or opportunity to influence the sale of electricity at a non-market price;
 - the incentive or opportunity to provide management or other services at below market price; or
 - the incentive or opportunity to protect the capital invested should the generation business face 'hard times', by further capital injection on favourable terms.
- 41 Incentives or opportunities to cross-subsidise generation activities from the electricity lines business, which may be created by an exemption, can only exist for the duration of the three month extension. Whether a permanent exemption from the ownership separation rules would create any such incentives or opportunities will be determined by the Commission in its consideration of Part A of the exemption application.

⁷ Top Energy does have use-of-system agreements with TransAlta and others for those electricity retailers to supply specific, large, consumers.

- 42 An effective extension of the date until which Top Energy would retain the option to establish a mirror trust would provide Top Energy with additional flexibility in complying with the ownership separation requirements of the EIR Act. While it may create incentives or opportunities to cross-subsidise generation activities from the lines business, the Commission considers that these would not be more than minimal.

A Relationship Not at Arms Length

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 an electricity supply business which is not at arms length?

- 43 A relationship which is not at arms length, which may be permitted by an exemption, can only exist for the duration of the three month extension. Whether a permanent exemption from the ownership separation rules would permit a relationship which is not at arms length will be determined by the Commission in its consideration of Part A of the exemption application.
- 44 An effective extension of the date until which Top Energy would retain the option to establish a mirror trust would provide Top Energy with additional flexibility in complying with the ownership separation requirements of the EIR Act. While it would permit a relationship which is not at arms length, the Commission considers that it would not be more than minimal.

THE COMMISSION'S DECISION

- 45 Top Energy's application passes all three of the criteria used by the Commission to decide upon exemptions from the EIR Act.
- 46 In making its decision the Commission notes that the facts revealed in Top Energy's application are particular to its situation alone. The Commission also notes that section 81(5) provides that the Commission may vary or revoke any exemption at any time.
- 47 Therefore, having considered the stated criteria, the Commission exempts Top Energy from the application of section 38(1)(c) and section 39 of the EIR Act, subject to the terms and conditions specified in the Notice of Exemption.

NOTICE OF EXEMPTION

The Commission, pursuant to section 81, exempts Top Energy Ltd from the application of section 38(1)(c) and section 39 of the Electricity Industry Reform Act 1998.

The exemption is subject to the following terms and conditions:

- (a) Definition:
 - 1 'Mirror Trust Establishment Day' means the 90th calendar day after the day of release of the Commission's decision on Part A of Top Energy Ltd's exemption application;
 - 2 'Mirror Trust Option' has the same meaning as sections 37 to 41 of the EIR Act save for the substitution of the Mirror Trust Establishment Day for any reference in those sections to 1 April 1999; and
- (b) That Top Energy Ltd may, at its discretion, implement the Mirror Trust Option by the Mirror Trust Establishment Day.
- (c) That Top Energy Ltd shall not implement the mirror trust option after the Mirror Trust Establishment Day.
- (d) That Top Energy Ltd shall comply with section 39 of the EIR Act as if it had not been exempted from that section and as if the Mirror Trust Establishment Day was substituted for any reference in that section to 1 April 1999.
- (e) That Top Energy shall be in full compliance with section 17 of the EIR Act from the Mirror Trust Establishment Day.

The exemption takes effect from the date of publication of this Notice in the *Gazette*.

The Commission may vary or revoke this exemption at any time in accordance with section 81(5) of the EIR Act.

Dated this 26th day of March 1999

The Commission