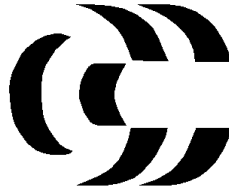


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COMMERCE COMMISSION

Decision No. 363

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:

FLETCHER CHALLENGE LIMITED

The Commission: K M Brown
E C A Harrison
E M Coutts
P R Rebstock

Commission Staff: S P Brown

Summary of Application: The Fletcher Challenge Group, 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. This Decision considers a temporary exemption whilst the Commission considers whether it will grant a permanent exemption.

Determination: The Commission, pursuant to section 81 of the EIR Act, exempts the Fletcher Challenge Group from the application of section 17 of the EIR Act for the period from 1 July 1999 until 5pm on the day on which the Commission gives its determination in the Fletcher Challenge Group's application for permanent exemption.

Date of Determination: 1 July 1999.

Date of Exemption: **On publication of the Notice of Exemption in the *Gazette*.**

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INTRODUCTION

- 1 On 22 June 1999, the Commerce Commission (the Commission) received an application from Fletcher Challenge Limited (FCL) for an exemption under section 81 of the EIR Act in respect of FCL and each of its related companies' involvement or interest in an electricity lines business in relation to the Fletcher Challenge Group (the FC Group). The FC Group consists of FCL, its related subsidiaries, and all relevant associate companies with potential involvements in electricity businesses.
- 2 Numerous entities within the FC Group are involved in electricity businesses. Based on the information provided by FCL, no single entity is cross-involved on its own. Due to the provision of the EIR Act, however, the FC Group, in aggregate, is cross-involved.
- 3 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.

FLETCHER CHALLENGE LIMITED

- 4 The FC Group is a New Zealand-based group of companies that operate both in New Zealand and overseas. The FC Group has four targeted, listed shares, reflecting group company operations in Building, Energy, Forests, and Paper. These shares are listed on the New Zealand, New York and Australian Stock Exchanges.

Electricity Supply Business Involvements

- 5 The FC Group has a number of involvements in electricity supply businesses in terms of the EIR Act, being as follows:
- 6 **Natural Gas Corporation (NGC):** FCL has a [] investment in NGC. NGC acquired the electricity retail business of WEL Energy Limited earlier this year. The retail business constitutes an electricity supply business for the purposes of the EIR Act. FCL is, therefore, currently involved in an electricity supply business through its investment in NGC.
- 7 With The Australian Gas Light Company (AGL) announcing its intention to acquire all of NGC, and NGC indicating a desire to sell, FCL will, when the sale takes effect, [] no longer have any interests in NGC or the Kapuni Gas Treatment Plant.
- 8 **Kapuni Gas Treatment Plant:** NGC has a [] interest in the Kapuni Gas Treatment Plant which has a capacity of [] MW. The plant generates [] GWh of electricity for the gas treatment process, [], and [] GWh is exported to the National Grid. The generation and supply of electricity to the National Grid constitutes an electricity supply business. FCL has an involvement in this business under the relevant thresholds in the EIR Act.
- 9 **Contract for Differences:** Fletcher Challenge Power Limited holds a long-term contract for differences from the [] for [] GWh per annum.

- 10 **Tasman Mill:** Tasman Pulp and Paper Company Limited owns and operates a [] MW capacity generator at the Tasman Mill. This partially supports Tasman's own on-site requirements. Tasman imports additional electricity for the remainder of its needs from the National Grid. The imported electricity also supplies very small amounts of electricity to on-site third party contractors. FCL has advised that the amount of supply is in the order (probably at the upper end) of [] kilowatt hours per annum (or in terms of the EIR Act, [] GWh per annum). Considered in isolation from the rest of the FC Group, this generation is solely for the Tasman Mill's own purposes and would be exempt from being an electricity supply business under section 5(2)(b) of the EIR Act.
- 11 **Waipa Sawmill:** [] owns the Waipa Sawmill. This generates [] GWh of electricity per annum. Of this, [] GWh per annum is used on-site by Waipa Sawmill and [] GWh per annum is exported from the site to [] local distribution network (now owned by [] Limited). The Waipa Sawmill is an electricity supply business in terms of the Act because it generates more than [] GWh of electricity per annum and not all of this is used for its own purposes.
- 12 **McKee Production Station:** Fletcher Challenge Energy - Taranaki generates [] GWh per annum all for its own use on site at its McKee production station.
- 13 **Fletcher Property Limited:** Fletcher Property Limited owns, operates, or is the head tenant of, a number of properties. (Two of the properties are owned by Fletcher Challenge Nominees Limited but are managed by Fletcher Property Limited. For the purposes of this application they have been included these buildings in the Fletcher Property Limited category, for ease of description). Fletcher Property Limited supplies [] GWh per annum to tenants or sub-tenants. Considered in isolation from the rest of the Fletcher Challenge Limited group, this quantum of supply to third party tenants is less than the [] GWh per annum exception contained in the EIR Act and accordingly, considered in isolation, Fletcher Property Limited is not an electricity supply business.
- 14 Fletcher Property Limited's current arrangement is that it purchases electricity as agent on behalf of its tenants and on-sells it to tenants under the terms in each lease. Fletcher Property Limited has advised the Commission that it currently passes on the same price as is charged by the electricity retailer direct to its tenants. It does not, and does not propose to, charge an agency fee or any other margin to the tenants for the electricity purchased on their behalf in the context of the lease arrangements.
- 15 Fletcher Property Limited's primary objective is stated to be to use its greater purchasing power to procure cheaper electricity prices for its tenants. The charge passed on to its tenants includes both the external network provider's charge for line function services and the cost of energy supplied. The charges for electricity supplied are determined in respect of each of the relevant properties. They are allocated to the individual tenants of each property on the basis of certain criteria, including the area occupied by the tenant, the electricity required for use by the individual tenant or any other criteria specific to the relevant lease. However, in all cases this is done at cost. In some cases, the charge is administered through the operating account with an annual wash-up provision for electricity actually used. Fletcher Property Limited wishes to enter into further centralised purchase contracts for the procurement and supply of electricity. This is to ensure its tenants receive the benefit of lower electricity prices

ELECTRICITY SUPPLY BUSINESS								
Relevant Entity	Total Amount of Electricity Sold or Supplied GWh/pa	Sale of Electricity Hedges	Trading in Rights to Sell or Trade Electricity	Generation Capacity GWh/pa	Generation Used for Own Purposes or for Purposes of Associates GWh/pa	Generation Sold to Third Parties GWh/pa	Generation Connected to National Grid	Generation Connected to Local Distribution Company
Tasman Pulp and Paper Limited								
Fletcher Challenge Forests Limited (Waipa Sawmill)								
Fletcher Property Limited								
Fletcher Challenge Energy Taranaki McKee production station								
Fletcher Wood Panels Limited								
Golden Bay Cement								
TOTAL]

Electricity Lines Business Involvements

22 The FC Group also has involvements in electricity lines businesses under the EIR Act:

23 **Fletcher Property Limited:** Based on the ruling in the Trans Tasman Properties exemption granted by the Commerce Commission (Decision 351A), the property portfolio owned or operated by Fletcher Property Limited constitutes an embedded lines business because electricity is conveyed through those wires to third party tenants or subtenants. Fletcher Property Limited conveys [] GWh per annum through its building portfolio. Of this, Fletcher Property Limited conveys [] GW per annum for its own use and use in common areas of the buildings and [] GW per annum is conveyed to third party tenants or sub-tenants. Fletcher Property supplies [] GW per annum to third party tenants. At its [] site however, [

]. The Commission has, therefore, excluded the [] GWh per annum Fletcher Property Limited supplies to its [] tenants from its conveyance figures. This explains the difference between the [] and the [] figures.

24 **Fletcher Wood Panels:** Fletcher Wood Panels Limited operates an electricity lines network at its Penrose site and supplies [] third parties with electricity – []. Fletcher Wood Panels meters and [

]. Its total conveyance on site is [] GW, of which the amount conveyed to third parties per annum is [] GW. At its Centennial Drive, Taupo site, Fletcher Wood Panels owns an on-site electricity network with an associate, Fletcher Challenge Forests. Fletcher Wood Panels conveys a total of [] GW hours per annum at this site. Of this amount, [] GW is conveyed for its own use and [] GW is conveyed to its associate, Fletcher Challenge Forests. On an aggregate basis, total conveyance amounts to [] GWh per annum, of which [] is for Fletcher Wood Panels Limited's own use or the use of its associates and [] GWh is conveyed for third parties.

- 25 **Tasman Mill:** The Tasman Mill generates [] GWh of electricity per annum. This electricity is conveyed through Tasman Mill's internal electricity distribution lines for Tasman Mill's own use. A nominal amount of electricity is imported from the National Grid and supplied to third party contractors at the Tasman Mill (a maximum of [] GWh per annum) and is conveyed to those contractors through Tasman Mill's internal electricity distribution system. FCL considers that this amount of conveyance is so nominal in actual and relative terms that it should be able to be ignored by the Commission in considering the overall position of the FC Group.
- 26 **Kapuni Gas Treatment Plant:** The Kapuni Gas Treatment Station produces [] GWh of electricity per annum. Of this, [] GWh is used in the gas treatment process, [], and [] GWh is exported to the National Grid. FCL state that NGC's joint venture partners, [] (and not NGC) own and operate the line which connects the generator unit to the National Grid by which the excess exported generation is [] or exported to the National Grid. Accordingly, FCL considers that this does not constitute an involvement the FC Group in an electricity lines business.
- 27 **Waipa Sawmill:** As stated above, the sawmill generator produces [] GW per annum of electricity. Approximately [] GW per annum is used on site and [] GWh per annum is exported to [] local distribution network. An associate of Fletcher Challenge Forests Limited owns the line which conveys the excess electricity to the point (just off-site) where it connects into the [] local distribution network. []. In terms of the EIR Act, the activity of conveying the [] GWh per annum of excess electricity to [] comes within exception 4(2)(d) – conveying electricity only from a generator to a local distribution network.
- 28 **Firth Industries:** Firth Industries Limited occupies 302 Great South Road, Greenlane. It conveys approximately [] GWh of electricity over the embedded lines in the building. About two thirds of this is for the company's own use, and a further third is supplied to a FC Group associate, Winstone Aggregates Limited.
- 29 **Golden Bay:** Golden Bay Cement Limited owns and operates two pole line 33 Kv feeders that convey electricity from [] Substation to its Portland Manufacturing site via a Golden Bay Cement owned substation at Portland Quarry. These wires convey electricity solely for Golden Bay Cement's own use.
- 30 In addition, Golden Bay Cement owns an 11 KV pole mounted feeder delivering energy via a Golden Bay Cement owned substation at the Portland Plant to its pump station on the Otaika River. This line primarily supplies Golden Bay's operations at

the pump station and quarry. It also conveys approximately [] KWh per annum of electricity to the [] (approximately [] gigawatt/hour per annum). As noted above in para. 24, FCL considers this amount to be nominal in actual and relative terms.

- 31 An aggregated analysis of the FC Group potential involvement in electricity lines business profile is set out below:

Electricity Lines Business				
Relevant Entity	Total amount of electricity conveyed GWh/pa	Total amount conveyed for own use or use of associates (GWh / pa)	Total amount conveyed for use of third parties (GWh / pa)	Amount conveyed from generator to local distribution network (GWh / pa)
Fletcher Property Limited	[
Tasman Pulp and Paper				
Kapuni Gas Treatment JV				
Fletcher Forests Waipa Sawmill				
Golden Bay Cement				
Fletcher Wood Panels				
Firth Industries				
Total]

INVOLVEMENTS

Electricity Lines Business

- 32 The FC Group in terms of the EIR Act:

- 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 exempted by section 4(2).

- 33 The FC Group:

- 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)).

- 34 Therefore, the FC Group is involved in an electricity lines business in terms of the EIR Act. FCL notes in its application that, on an aggregated basis, and on the basis of the Commission's previous rulings in this area, the FC Group is involved in an electricity lines business because:

- it conveys in the aggregate more than 2.5 GWh per annum; but
- it does not convey all electricity for its own use or for the use of its associates.

Electricity Supply Business

- 35 The FC Group in terms of the EIR Act:
- sells electricity in New Zealand (s5(1)(a)(i));
 - owns and operates directly a generator in New Zealand;
 - owns and operates directly core assets of an electricity retail business which include a customer data base relating to and used for the purposes of an electricity retail or electricity trading business and the benefit of contracts to sell electricity (s5(1)(c)); and
 - has no activities exempted by section 5(2).
- 36 The FC Group:
- carries on an electricity supply business alone or together with associates (s7(1)(a));
 - exceeds the 10% threshold in terms of control rights and equity return rights in that business (s7(1)(b)); and
 - has material influence over that business (s7(1)(c)).
- 37 Therefore, the FC Group is also currently involved in an electricity supply business in terms of the EIR Act. FCL agrees with this interpretation.

CROSS-OWNERSHIP PROHIBITION

- 38 Section 17 of the EIR Act 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.”
- 39 The FC Group is involved in both an electricity lines and an electricity supply business. The FC Group will, after 1 July 1999, have a prohibited cross-involvement, in terms of section 17 of the EIR Act.

THE EXEMPTION APPLICATION

- 40 FCL has sought an exemption under section 81 of the EIR Act for FCL, each of its related companies, and all relevant associate companies, in respect of any involvement or interest in an electricity lines business described in its application.
- 41 This Decision deals solely with FCL’s request for a temporary exemption from 1 July 1999 while the Commission considers FCL’s application for permanent exemption.

COMMISSION PROCEDURES

General

- 42 For the purpose of considering FCL's application for an exemption under section 81 of the EIR Act, 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, E M Coutts and P R Rebstock.
- 43 The Commission's determination 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

- 44 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.3.¹
- 45 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
 - (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.”

- 46 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,⁽²⁾ expected.”
- 47 The Commission stated in Practice Note No.3 that:
- “On receipt of an application the Commission will determine whether granting an exemption

¹ Practice Note No.3, September 1998, Electricity Industry EIR Act 1998 Commission's Role and Processes.

² For example, of the types provided for in section 19 of the EIR Act.

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

48 The national electricity retail market appears relevant to the application of the Commission's criteria to the facts of FCL's application for temporary exemption.³

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?

49 Fletcher Property Limited does not charge any separate lines fee or other charge to tenants or retailers wishing to supply electricity to tenants. Currently, the cost of maintaining the embedded wires, along with other operating expenses, is passed through to individual tenants at cost. Fletcher Property does not propose to require any line charges from either tenants or landlords in the future. []

50 Fletcher Property Limited and Fletcher Wood Panels Limited do not and do not propose to require use of system agreements from retailers wishing to sell electricity to their tenants. Consistent with previous Commission decisions of other property companies, Fletcher Property Limited and Fletcher Wood Panels Limited would be at risk of both Commerce Act 1986 and EIR Act penalties if either were to unreasonably restrict retailers accessing its embedded lines to supply tenants.

51 The amount of electricity the FC Group conveys to consumers other than itself or its associated companies is small, i.e. [] GWh per annum or [] of the total amount

³ 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 generation market, do not appear to be relevant to this application for exemption.

conveyed. As noted in the Carter Holt Harvey decision (Decision No. 344), if this were the FC Group's only involvement in a lines business, it would be excluded from the application of the definition of an electricity lines business by section 4(2)(a) of the EIR Act. However, the FC Group also conveys a large amount of electricity, by lines it owns and operates, for its own or associates' consumption, and this takes it outside the exception criterion.

- 52 Practically, the small amount conveyed to third parties means the FC Group as a whole has only very limited non-material incentives or opportunities to cross subsidise electricity retail charges with line charges.
- 53 Fletcher Property Limited's status as a landlord decreases any incentives to impose additional lines charges for either retailers or tenants. Fletcher Property Limited's objective as landlord is to maximise occupancy rates by ensuring tenants' total occupation costs, including electricity are minimised.
- 54 The Commission considers an effective extension of the date until the FC Group must comply with the ownership separation rules may create incentives or opportunities for the FC Group to inhibit competition in the national electricity retail 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?

- 55 FCL considers that the FC Group has little or no incentive or opportunity to cross-subsidise its generation activities from its lines business activities as those activities relate to the conveyance of electricity to those parties. Its lines business activities in respect of non-FC Group members relate to only [] GWh per annum and are confined to the conveyance of electricity to tenants and subtenants of Fletcher Wood Panels Limited and Fletcher Property Limited. This compares to FC Group's generation activities of [] GWh per annum. In relation to the Waipa Sawmill site, although it owns the line that conveys electricity to the local distribution network, TrustPower manages and operates the line. The conveyance itself does not give rise to an incentive or opportunity to cross-subsidise the FC Group's generation activities.
- 56 The generation activities of the FC Group are conducted in companies other than Fletcher Property Limited and Fletcher Wood Panels Limited.
- 57 The Commission considers an effective extension of the date until the FC Group must comply with the ownership separation rules may create incentives or opportunities for the FC Group to cross-subsidise its generation activities, but 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?

- 58 Considered in isolation from the rest of the group, Fletcher Property Limited is not both an electricity lines business and an electricity supply business. It does not sell more than 2.5 GWh of electricity per annum to its tenants and subtenants (please see exception 5(2)(a)). A similar analysis applies to Fletcher Wood Panels (i.e. sale of less than 2.5 GWh per annum to third parties).
- 59 Absent an exemption, FC Group will continue to be involved in both electricity lines (through Fletcher Property Limited and Fletcher Wood Panels Limited) and electricity supply through other FC Group involvements. However, FCL considers that the potential effects of the relationship not being at arm's length can only be applied to the approximately [] GWh per annum of electricity that Fletcher Property Limited and Fletcher Wood Panels Limited convey to third parties. In accordance with the CHH decision, FCL submits that the effects of this relationship are not material and will not suborn the purposes of the EIR Act.
- 60 A relationship which is not at arms length, which may be permitted by an exemption, can only exist for the duration of the temporary extension. Whether a permanent exemption would permit a relationship which is not at arms length will be determined by the Commission in its consideration of the exemption application.
- 61 The Commission considers that an effective extension of the date until which the FC Group must comply with the ownership separation rules would permit a relationship which is not at arms length, but that the effect during the time extension would not be more than minimal.

THE COMMISSION'S DECISION

- 62 This Decision deals solely with FCL's request for a temporary exemption from 1 July 1999 while the Commission considers FCL's application for permanent exemption. FCL's application passes all three criteria used by the Commission to decide upon exemptions from the EIR Act.
- 63 The Commission notes that section 81(5) provides that the Commission may vary or revoke any exemption at any time.
- 64 Therefore, having considered the stated criteria, the Commission exempts the FC Group, for a limited period, from the application of section 17 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 of the Electricity Industry Reform Act 1998, exempts the Fletcher Challenge Group from the application of section 17 of the EIR Act in relation to

its current involvements in electricity supply businesses and electricity lines businesses as described in an application to the Commission dated 22 June 1999.

The following entities are included in the Group, and therefore, this exemption:

- Fletcher Challenge Limited;
- Fletcher Challenge Power Limited;
- Tasman Pulp and Paper Company Limited;
- Fletcher Challenge Forests Limited;
- Fletcher Challenge Energy;
- Fletcher Property Limited;
- Fletcher Wood Panels Limited;
- Firth Industries Limited;
- Winstone Aggregates Limited; and
- Golden Bay Cement Limited.

The exemption is subject to the following terms and conditions:

- (a) The exemption applies from 1 July 1999 until 5pm on the day on which the Commission gives its determination in the Fletcher Challenge Group's application for permanent exemption.
- (b) The Fletcher Challenge Group will not acquire any new involvements in lines businesses which involve the conveyance of electricity to third parties without notifying the Commission.
- (c) The Fletcher Challenge Group shall be in full compliance with section 17 of the EIR Act on expiration of this exemption.

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

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

Dated this day of July 1999

The Commission