



## COMMERCE COMMISSION

### Decision No. 615

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

#### **BABCOCK & BROWN INFRASTRUCTURE LIMITED**

**The Commission:** Paula Rebstock  
Denese Bates QC

**Summary of the Application:** Application by Babcock & Brown Infrastructure Limited for exemption from section 17 of the EIR Act in respect of certain prohibited cross-involvements that would result from an incidental and temporary ownership interest in Glenbrook Power Station.

**Determination:** The Commission, pursuant to section 81 of the EIR Act, determines to grant an exemption from section 17 on the conditions specified in the Notice of Exemption.

**Date of Determination:** 30 August 2007

**Date of Exemption:** This exemption takes effect upon publication in the New Zealand Gazette.

**CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS**

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## INTRODUCTION

- 1 On 30 August 2007, the Commerce Commission (the Commission) registered an application from Babcock & Brown Infrastructure Limited (BBI) for exemption from section 17<sup>1</sup> of the Electricity Industry Reform Act 1998 (the EIR Act).
- 2 BBI is a stapled entity listed on the ASX and the NZX, and comprised of Babcock & Brown Infrastructure Limited and Babcock & Brown Infrastructure Trust. 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.
- 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 BBP, listed on the ASX, is a specialist infrastructure entity which provides investors access to an electricity generation portfolio.
- 5 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 wide variety of assets, which will be split between the consortium members.
- 6 Included in those assets is the Glenbrook Power Station (Glenbrook). 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.
- 7 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. 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 31 August 2007 before being transferred to the various consortium participants.
- 8 BBP has agreed to acquire the Alinta power generation portfolio, which includes Glenbrook. The effect of the transaction process means that BBI will be 'involved' temporarily in an electricity supply business until Glenbrook is transferred to BBP.
- 9 BBI is seeking an exemption from 31 August 2007, when the assets are acquired by ES&L, until Glenbrook is transferred to BBP. BBI estimates that a timeframe of four weeks is realistic and seeks an exemption for that period of time.

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<sup>1</sup> Section 17 prohibits a person from being cross-involved in an electricity lines business and an electricity supply business.

## COMMISSION PROCEDURES

### General

- 10 For the purpose of considering this application for exemption, the Commission, in terms of s73 of the Crown Entities Act 2004, has delegated its powers under s81 of the EIR Act to Paula Rebstock, Chair and Denese Bates QC, Commissioner.

### Criteria Used by the Commission to Consider Exemption Applications

- 11 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.<sup>2</sup>
- 12 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 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 Act. That is, the purpose of the EIR Act 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.

- 13 Practice Note No.3 states that :

On receipt of an application in the prescribed form, 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 Act.

The Commission's tests would necessitate obtaining and evaluating objective answers to the following 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?

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<sup>2</sup> Practice Note No.3, September 1998, Electricity Industry Reform Act 1998 Commission's Role and Processes.

- 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:

- The relevant market(s)<sup>3</sup> 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.

## APPLICATION OF THE ACT

### Electricity Lines Business Involvements

14 The definition of “electricity lines business” appears in s4(1) of the EIR Act. That provides as follows:

#### 4. Meaning of ‘electricity lines business’

- (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.

15 There are a number of exceptions to this definition in subsection (2):

- (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:
  - (b) Conveying electricity solely for its own consumption or for the consumption of its associates:
  - (c) Conveying electricity only from a generator to the national grid or from the national grid to a generator:
  - (d) Conveying electricity (other than via the national grid) only from a generator to a local distribution network or from a local distribution network to a generator:
  - (e) Conveying electricity by lines that are owned or operated by a business that also owns or operates a generator which generates electricity solely for the consumption of a local community, where both those lines and that generator are not connected, directly or indirectly, to the national grid:
  - (f) Conveying electricity only by a line or lines that are mostly in competition with a line or lines operated by another electricity lines business that is not an associate of the person, provided that the competition is actual competition and not potential competition:
  - (g) Owning or operating, directly or indirectly, lines referred to in any of paragraphs (a) to (f) or any other core assets of an electricity lines business used in connection with those lines.

16 Through its ownership of Powerco, BBI falls within the definition in s4(1)(a) and (b) and is not excepted by s(4)(2). Accordingly, BBI is considered to be an electricity lines business.

### Electricity Supply Business Involvements

17 The EIR Act provides for the definition of “electricity supply business” in s5(1):

#### 5. Meaning of ‘electricity supply business’

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<sup>3</sup> Defined using the same process as used for market definitions in respect of Commerce Act matters.

- (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.

18 Subsection (2) provides for a number of exemptions from s5(1):

- (2) None of the following activities brings a person within subsection (1):
- (a) Selling or generating less than 2.5 GWh per annum;
  - (b) Generating or selling electricity solely for its own consumption or for the consumption of its associates;
  - (c) Generating electricity solely for the consumption of a local community, where -
    - (i) The generator is owned or operated by a business that also conveys electricity by line; and
    - (ii) Both those lines and that generator are not connected, directly or indirectly, to the national grid;
  - (d) Selling electricity that is generated at a generator referred to in paragraph (c) or subsection (3);
  - (e) Generating electricity from distributed generation, and selling the electricity generated, where –
    - (i) the generating capacity of the distributed generation is no more, at any one time, than the greater of 5MW (determined according to the nameplate or nameplates) and 2% of the maximum demand, in the immediately preceding financial year, of the system to which the distributed generation is connected; and
    - (ii) the distributed generation is owned or operated by a business that also conveys electricity by line and that distributed generation is connected to those lines;
  - (f) Selling financial transmission rights that hedge risks arising from the effects of losses and constraints on the national grid;
  - (g) Owning or operating, directly or indirectly, a generator referred to in any of the paragraphs (b) to (f) or subsection (3) or any other core generation assets used in connection with those generators.

19 Through the proposed, acquisition, BBI would be deemed to be an electricity supply business by way of s5(1)(a)(i) and (iii) and also through 5(1)(b) and 5(1)(c)(ii).

20 Accordingly, the proposal would result in BBI being an electricity supply business, albeit temporarily.

## **Cross-Ownership Prohibition**

21 One of the key intentions of the EIR Act on its inception was to effect ownership separation between electricity supply and electricity lines businesses, as they are defined by the EIR Act. Accordingly, s17 of the EIR Act expressly prohibits such cross-ownership. It provides:

### **17. Cross-ownership prohibition –**

- (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.

## **The Meaning of Cross-involvement**

22 Section 7(1) of the EIR Act defines “involved” :

### **7. Meaning of ‘involved’**

- (1) For the purposes of this Act, a person is involved in an electricity business if the person –
  - (a) Carries on that business, either alone or together with its associates and either on its own or another’s behalf; or
  - (b) Exceeds the 10% threshold in section 8 in respect of that business; or
  - (c) Has material influence over the business; -
 and ‘involvement’ has a corresponding meaning.

23 Section 11 of the EIR Act defines “material influence” :

- (1) Without limiting the ordinary meaning of the expression “material influence”, the following people are deemed to have material influence over an electricity business:
  - (a) A manager of a person that carries on the business:
  - (b) If the business is carried on by a natural person, that person:
  - (c) A person in accordance with whose directions, instructions, or wishes a person referred to in either of paragraph (a) or paragraph (b), or the business, may be required or is accustomed to act in respect of the carrying on or management of the business:
  - (d) A person that exercises or that is entitled to exercise, or who controls or is entitled to control the exercise of, powers which would ordinarily fall to be exercised by a person referred to in either of paragraph (a) or paragraph (b):
  - (e) A person that can appoint or remove, or control the appointment or removal of, a person referred to in either of paragraph (a) or paragraph (b):
  - (f) A person that has a power to influence a decision of the business which would ordinarily require the holding of control rights which would cause the person to exceed the 10% threshold:
  - (g) A person in circumstances where that person and the business is acting, or proposing to act, jointly or in concert in relation to the business; or
  - (h) A person that, under a trust or agreement (whether or not the person is a party to it), may at any time have any of the powers referred to in paragraph (c) to paragraph (f).
- (2) Where a person has material influence over an electricity business under this section, and another person has any of the powers or controls referred to in paragraph (c) to paragraph (h) in relation to the first person or the majority of its managers, then that other person is deemed also to have material influence over the business, and so on.(3) A person is deemed to have material influence over an electricity business if the person is one of 2 or more associates who, together, have material influence over the business.
- (4) Subsection (3) does not apply to deem a person to have material influence over a business only because that person is, under section 12(1)(b) or (c), an associate of another person, provided

those associates act in accordance with the arms length rules (with all necessary modifications) in respect of the business.

(5) For the avoidance of doubt, a power to cast one of many votes at an election of trustees or councillors does not, of itself, constitute material influence.

24 The Commission considers that all parties deemed to be involved in both BBI's electricity lines business, Powerco and BBI's proposed temporary involvement in an electricity supply business would be deemed to be cross-involved themselves.

25 If the Commission determined to grant an exemption for the proposal, any such involvements could be disregarded through the operation of s19(1)(h):

**19. Certain businesses and involvements to be disregarded**

(1) For the purposes of this Act, no account is to be taken of a person's business, or involvement or interest in a business, if- ...

(h) The business, involvement, or interest is exempted by the Commission under s81...

26 In that event, all otherwise prohibited cross-involvements that would stem directly from the cross-involvement of BBI could be disregarded for the purposes of this determination.

**The Commission's Exemption Power**

27 Section 81(1) of the EIR Act provides the Commission with a power of exemption:

(1) The Commission may, for the purposes of this Act, in its discretion and upon the terms and conditions (if any) that it thinks fit, by notice in the *Gazette*, exempt—

(a) any business, involvement, or interest, or class of business, involvement, or interest, from the application of this Act; or

(b) any person or class of persons from compliance with any provisions of this Act or any regulations made under it.

**EXEMPTION SOUGHT**

28 BBI seeks a four week exemption from section 17 of the EIR Act in relation to its incidental and temporary ownership of Glenbrook and has offered to comply with several conditions.

29 BBI submits that 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. Furthermore, BBI states that 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.

30 The arrangements are to be 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.

31 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. BBI states that the arrangements have

been put in place for commercial reasons, as BBP has an interest in BBI not having access to Glenbrook information.

- 32 BBI proposes the following ring fencing arrangements as conditions to any exemption granted in respect of its application:
- no common officers or employees of BBI and the companies with direct ownership of the Glenbrook assets;
  - no information relating to the day to day operation of Glenbrook disclosed to any officers or employees of BBI; and
  - no officer or employee of BBI involved in decisions relating to the management of Glenbrook.
- 33 In this instance, because of the short period of time for which the exemption is sought, together with the conditions offered by BBI, the Commission has not conducted a full investigation of BBI's submissions.

## **EXAMINATION IN TERMS OF THE COMMISSION'S CRITERIA**

### **Question 1: 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?

- 34 BBI submits that there will be no opportunity to inhibit competition because BBI's temporary ownership of Glenbrook will arise incidentally in the context of a large transaction process. Furthermore, 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.
- 35 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.
- 36 In addition, there will be no incentives to inhibit competition as BBI has no economic interest in Glenbrook or BBP, nor does it have any control over Glenbrook's finances.
- 37 The Commission is of the view that, given the short term nature of the cross-involvement, providing the proposed ring fencing provisions are implemented by BBI, the granting of an exemption in this case would not create incentives or opportunities for BBI to inhibit competition in the electricity industry.

### **Question 2: 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?

- 38 As stated above, BBI will have no economic interest in Glenbrook. All profits will flow to BBP. In addition, the cross-involvement will be for no longer than four weeks.

- 39 Accordingly, the Commission is of the view that the temporary cross-involvement is unlikely to give rise to incentives or opportunities for BBI to cross-subsidise Glenbrook from its electricity lines business.

**Question 3: 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?

- 40 BBI submits that in Decision 541, the Commission acknowledged that compliance with the arms length rules is not always strictly necessary, paragraph 76 of that Decision states:
- 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.*
- 41 Further, BBI argues that 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.
- 42 BBI submits that its cross-involvement will be a technical and temporary one and that 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.
- 43 The Commission considers that providing the proposed ring fencing provisions are implemented by the BBI, and as the cross-involvement is unlikely either to create incentives or opportunities to inhibit competition in the electricity industry or to cross-subsidise generation activities from an electricity lines business, in this case, non-compliance with the Arms Length Rules is unlikely to have any material adverse effect.

**Conclusion**

- 44 The Commission considers that the granting of a limited exemption, in this case, would not create incentives or opportunities to inhibit competition in the electricity industry.
- 45 Further, the Commission considers that the exemption would create a relationship between an electricity supply business and an electricity lines business that is other than at arms length but that that relationship, due to the above considerations, would have no practical effect on the purposes of the EIR Act.

- 46 Accordingly, the Commission determines to grant a limited exemption to BBI from s17 of the EIR Act in respect of the cross-involvements outlined in the application, subject to the following conditions:
- 1 no officers or employees of BBI are to be officers or employees of the companies with direct ownership of the Glenbrook assets;
  - 2 no officers or employees of BBI shall access any information relating to the day to day operation of Glenbrook;
  - 3 no officers or employees of BBI are to be involved in decisions relating to the management of Glenbrook;
  - 4 this exemption is for a period of four weeks from 31 August 2007 and expires at midnight on 30 September 2007;
  - 5 BBI will advise the Commission when the cross-involvement ceases; and
  - 6 this exemption is specific to the cross-involvements created through BBI's incidental and temporary involvement in Glenbrook. It does not extend to any other interest either existing or future cross-involvement of BBI.
- 47 The exemption takes effect from the date of its publication in the New Zealand Gazette.

**THE COMMISSION'S DETERMINATION**

48 The Commission determines to grant an exemption from section 17 of the EIR Act, subject to the terms and conditions stated in the Notice of Exemption.

Dated this 30<sup>th</sup> day of August 2007

Paula Rebstock  
Chair

## **NOTICE OF EXEMPTION**

The Commerce Commission (Commission), pursuant to section 81 of the Electricity Industry Reform Act 1998 (the EIR Act), exempts Babcock & Brown Infrastructure Limited (BBI) from the application of section 17 of the EIR Act in respect of the cross-involvement (as that term is defined in the EIR Act) that would be created through its incidental and temporary ownership of the Glenbrook Power Station (Glenbrook) as outlined in its application for exemption registered by the Commission on 30 August 2007.

The exemption is subject to the following conditions:

- 1 no officers or employees of BBI are to be officers or employees of the companies with direct ownership of the Glenbrook assets;
- 2 no officers or employees of BBI shall access any information relating to the day to day operation of Glenbrook;
- 3 no officers or employees of BBI are to be involved in decisions relating to the management of Glenbrook;
- 4 this exemption is for a period of four weeks from 31 August 2007 and expires at midnight on 30 September 2007;
- 5 BBI will advise the Commission when the cross-involvement ceases; and
- 6 this exemption is specific to the cross-involvements created through BBI's incidental and temporary involvement in Glenbrook. It does not extend to any other interest either existing or future cross-involvement of BBI.

The exemption takes effect from the date of publication of this notice in the New Zealand Gazette.

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

Dated this 30<sup>th</sup> day of August 2007

Paula Rebstock  
Chair