

Public Version

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11 March 2005

Chief Investigator
Business Acquisitions
Commerce Commission
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EXEMPTION APPLICATION UNDER SECTION 81(1) OF THE ELECTRICITY INDUSTRY REFORM ACT 1998

- 1 We act for Wayne Boyd and Meridian Energy Limited (*Meridian*), who have asked us to make this application on Mr Boyd's behalf for an exemption under section 81(1) of the Electricity Industry Reform Act 1998 (*EIR Act*).

Date of application

- 2 The date of this application is 11 March 2005.

Application

- 3 Pursuant to section 81(1) of the EIR Act, application is hereby made to the Commerce Commission for exemption from the application of section 17 the EIR Act, as described in this application.

Details of persons filing the application

- 4 The applicant is Wayne Robert Boyd.
- 5 This application has been prepared and filed by, and correspondence should be sent to:

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General Counsel
Meridian Energy Limited
Level 2
15 Allen St
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Telephone: 04 381 1230
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cc Frank McLaughlin
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Urgency

- 6 Subject to the Commission granting the exemption sought, Meridian wishes Mr Boyd to commence his role as a director as soon as possible, preferably from the date of the next scheduled board meeting on 5 April 2005. Accordingly the applicant and Meridian request that the Commission, to the extent it is able, treat this application with urgency.

Details of the Exemption Sought

- 7 Mr Boyd seeks an exemption from the application of section 17 of the EIR Act.
- 8 Mr Boyd is Chairman of the board of directors of Auckland International Airport Limited (*AIAL*), an electricity lines business within the meaning of the EIR Act. It is proposed that Mr Boyd be appointed a director of Meridian, an electricity supply business within the meaning of the EIR Act.
- 9 The circumstances of this application, and the exemption sought, is substantially similar to the exemptions sought, and granted by the Commission in relation to:

9.1 Ms Joan Withers (Decision 384);

9.2 Dr Keith Turner (Decision 517).

10 In short:

- 10.1 Meridian falls within the definition of an *electricity supply business* under the EIR Act (see schedule 1 for more detailed analysis).
- 10.2 The Commerce Commission has previously found AIAL to be an *electricity lines business* under the EIR Act (paragraph 19, Decision 338, paragraph 13, Decision 384, and paragraph 16, Decision 517) (see schedule 2 for more detailed analysis of AIAL's categorisation).
- 10.3 Consistent with the Commission's Decisions 384 and 517, Mr Boyd is deemed to be involved in an electricity lines business by virtue of his directorship of AIAL, and will be deemed to be involved in an electricity supply business if appointed to the board of Meridian (see schedule 3 for detailed analysis).
- 10.4 Section 17 of the EIR Act provides that no person involved in an electricity lines business may be involved in an electricity supply business (and vice versa).

11 Mr Boyd therefore is applying to the Commission under section 81 of the EIR Act for exemption from the application of section 17 of the EIR Act.

Grounds for the exemption sought

12 As we explain below, there is no business relationship between Meridian and AIAL in which Mr Boyd would be cross-involved. In particular:

- 12.1 There is no connection or relationship between the electricity supply business of Meridian and the electricity lines business of AIAL, in which Mr Boyd will be involved.
- 12.2 Meridian is not, nor does it propose to become, an electricity retailer to tenants or consumers connected to AIAL's electricity network.

13 Furthermore we note that:

- 13.1 There is no cross-ownership at shareholder level; Meridian is a state-owned enterprise while AIAL is a listed company in which the Crown holds no interest.
- 13.2 To the extent that Mr Boyd could influence a decision of AIAL in relation to a proposed transaction with Meridian by exercising his vote as a director of AIAL, Mr Boyd would be prohibited from voting on that matter by the NZX Listing Rules.

13.3 To the extent that Mr Boyd could influence a decision of Meridian in relation to a proposed transaction with AIAL by exercising his vote as a director of Meridian, Mr Boyd would be prohibited from voting on that matter by Meridian's constitution.

Unconditional exemption sought

14 Meridian and Mr Boyd consider that the application (supported by the arguments advanced below in paragraphs 18 to 32) satisfies the Commission's criteria for granting an unconditional exemption from the application of section 17 of the EIR Act.

15 However, if the Commission determines that it is not able to grant an unconditional exemption, then Meridian and Mr Boyd propose that the Commission grant the exemption on the condition that there should not in future be any connection or relationship between the two companies in respect of electricity supply or distribution whilst Mr Boyd remains involved in both.

16 The applicant notes that this condition is identical to the condition of the exemption granted by the Commission in Decisions 384 and 517.

Arguments in support of this application

17 We submit that Mr Boyd's involvement in AIAL and Meridian:

17.1 will not create incentives or opportunities which will inhibit competition in the electricity industry;

17.2 will not create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses; and

17.3 will not result in relationships between an electricity lines business and an electricity supply business which are not at arms length,

on the grounds set out below.

Relevant markets

18 We consider that the relevant markets for the purposes of this application are the national electricity generation and electricity retail markets and AIAL's local distribution market.

COMMISSION'S CRITERIA**Incentives or opportunities of Mr Boyd to inhibit competition in the electricity industry**

No current or proposed relationship between the businesses of AIAL and Meridian

- 19 There is no connection or relationship between the electricity supply business of Meridian and the electricity lines business of AIAL, in which Mr Boyd will be involved. More specifically, Meridian is not, nor does it propose to become, an electricity retailer to any tenant or consumer connected to AIAL's electricity network.

Trustpower is the incumbent electricity retailer

- 20 As a result of the Commission's decision concerning AIAL's exemption application (Decision 338), AIAL retained its electricity lines business and sold its electricity supply business to Trustpower Limited (*Trustpower*). Meridian is advised by AIAL that 173 consumers are currently connected to AIAL's network.

- 21 Although AIAL's tenants and consumers are free to choose their preferred electricity supplier, currently Trustpower is the only incumbent retailer at the airport. Trustpower and AIAL have entered into a use-of-systems agreement under which access to AIAL's lines network is provided to Trustpower. To enter the market, Meridian would have to negotiate a use-of-systems agreement with AIAL, and AIAL has stated that the same agreement as with Trustpower would be available to any other retailer. If it did discriminate materially, it would be at risk under sections 27 and 36 of the Commerce Act.

AIAL's electricity lines business comprises only a small part of AIAL's overall business

- 22 AIAL's primary business is that of managing and operating an international airport, not an electricity lines company. It is not an *electricity* company, in the ordinary sense of the word. AIAL has advised that its electricity lines business comprises 1.1% of its overall business, in terms of its revenues. Accordingly there is little commercial incentive in Mr Boyd, through his role as a director of AIAL, seeking to inhibit competition in the electricity industry.

Incentives or opportunities of AIAL to cross-subsidise Meridian's generation activities from its line business resulting from Mr Boyd's presence as a director of both AIAL and Meridian

- 23 As stated above there is no current or proposed connection or relationship between the electricity supply business of Meridian and the electricity lines business of AIAL, in which Mr Boyd will be involved.

A relationship between AIAL and Meridian not at arms' length due to Mr Boyd's presence as a director of both AIAL and Meridian

- 24 As stated above, Meridian is not currently, and neither AIAL nor Meridian propose that Meridian become, an electricity retailer to consumers connected to AIAL's electricity network.
- 25 However, in the unlikely event that Meridian does become an electricity retailer to AIAL's electricity consumers, Meridian would have to negotiate a use-of-system agreement with AIAL. Such agreement would generally be:
- 25.1 negotiated by management of each company under delegated authority, and not by the boards; and
- 25.2 in an industry-standard form.
- 26 Accordingly the ability for Mr Boyd, by virtue of his common directorship of both Meridian and AIAL, to create a relationship that is not at arms' length is very limited.

Management and operational policies support arms length practices and transactions

- 27 As a matter of practice, entry by Meridian into a (small scale) standard use-of-systems agreement with AIAL would be regarded as a routine management issue and would not be elevated to board level.

Both AIAL's and Meridian's constitution regulate conflicts of interest

- 28 AIAL's equity securities are quoted on New Zealand Exchange Limited (NZX). In the event that Meridian proposes to supply AIAL's own electricity requirements or enter into a use-of-systems agreement with AIAL, Mr Boyd is prohibited under the NZX Listing Rules from voting or being included in a quorum for the purposes of considering that matter as Mr Boyd would be "interested" in that transaction (details of the voting prohibition on Mr Boyd as a director of AIAL are set out in schedule 4).
- 29 Details of Meridian's constitutional limitations on participation by conflicted directors in board decisions are set out in Schedule 5. In short, Meridian's constitution takes a strict line on conflict matters and provides that a

director may not vote on a matter relating to an interested transaction (clause 26.1) except in certain limited circumstances.

Existing common directorships will not create further incentives or opportunities

30 The applicant notes that Joan Withers and Dr Keith Turner are already both "involved" in the electricity supply business of Meridian (as a director and chief executive officer, respectively) and "involved" in the electricity lines business of AIAL (both as directors of AIAL). As noted above, the Commission has previously granted an exemption from the application of section 17 in respect of both these persons.

31 In the view of the applicant, the appointment of Mr Boyd to the board of Meridian will not increase the incentives or opportunities for any of the mischief the EIR Act is trying prevent. The applicant notes:

31.1 the commercial incentives or opportunities for Meridian to expand into AIAL's retail market (and particularly to supply AIAL's current electricity consumers) will not change as a result of Mr Boyd's appointment to the Meridian board;

31.2 the voting restrictions referred to above will apply to Ms Withers and Dr Turner, in so far as Ms Withers is a director of Meridian and/or Ms Withers and Dr Turner are directors of AIAL.

Proposed condition for exemption

32 As stated above, both Meridian and Mr Boyd consider that the application satisfies the Commission's criteria for granting an unconditional exemption from the application of section 17 of the EIR Act.

33 However, if the Commission determines that it is not able to grant an unconditional exemption, then Meridian and Mr Boyd propose that the Commission grant the exemption on the condition that there should not in future be any connection or relationship between the two companies in respect of electricity supply or distribution whilst Mr Boyd remains involved in both.

Attachments

34 Attached in support of this application are:

34.1 [

];

34.2 a Declaration, in the prescribed form, by Mr Boyd as applicant.

Fees

35 We also **attach** a bank cheque for \$11,250.00 for fees prescribed for exemption applications under the Electricity Industry Reform Act (Fees) Regulations 1998. Please advise us of the actual cost of processing this application and the amount of refund as soon as practicable.

Discussion

36 We would be happy to discuss with the Commission any aspect of this application.

Yours faithfully

Frank McLaughlin
Partner

SCHEDULE 1 – CATEGORISATION DETAILS OF MERIDIAN

- 1 In terms of the EIR Act, Meridian:
 - 1.1 sells electricity in New Zealand (s5(1)(a)(i));
 - 1.2 generates electricity in New Zealand (s5(1)(a)(iii));
 - 1.3 owns and operates directly generators in New Zealand (s5(1)(b));
 - 1.4 owns and operates directly core assets of an electricity retail business which include the benefit of contracts to sell electricity (s5(1)(c)); and
 - 1.5 does not fall within any of the exclusions listed in sections 5(2) or 5(3).
- 2 Therefore Meridian is an electricity supply business in terms of the EIR Act.

SCHEDULE 2 – CATEGORISATION DETAILS OF AIAL

- 1 AIAL is a public company listed on NZX. It owns and operates Auckland Airport. Its major shareholders are New Zealand Central Securities Depository Limited, Citicorp Nominees Pty Limited, and the Auckland and Manukau City Councils.
- 2 AIAL owns an electricity distribution network at the Airport. The network operates at 11,000 and 400 volts and comprises transformers, switchgear and underground cables. The network connects to Vector Limited's city-wide network at the perimeter of the Airport. AIAL is a lines customer of Vector Limited.
- 3 AIAL distributes electricity to 173 consumers at the Airport.¹ AIAL levies a lines charge on the consumers for the provision of such line function services.²
- 4 In terms of the EIR Act, AIAL:
 - 4.1 conveys electricity by line in New Zealand (s4(1)(a));
 - 4.2 owns and operates, directly, lines in New Zealand, and other core assets of an electricity lines business (s4(1)(b)); and
 - 4.3 does not fall within any of the exclusions listed in section 4(2).
- 5 Therefore AIAL is an electricity lines business in terms of the EIR Act.

¹ Of the 80 gigawatt-hours per annum distributed, 23 is for AIAL's use.

² Electricity retailers TrustPower Limited, Genesis Power Limited, Contact Energy Limited, and Mighty River Power Limited each have access to AIAL's network in order that they may retail electricity to consumers connected to AIAL's network.

SCHEDULE 3 – MR BOYD’S INVOLVEMENTS IN AIAL AND MERIDIAN

- 1 Mr Boyd is a director of an electricity lines business (AIAL) and wishes to be a director of an electricity supply business (Meridian). In terms of the EIR Act:
 - 1.1 AIAL and Meridian are both bodies corporate;
 - 1.2 Mr Boyd is a “manager” of AIAL by virtue of being a director of AIAL and proposes to be a “manager” of Meridian also by virtue of being a director of Meridian (s3);
 - 1.3 without limiting the ordinary meaning of the expression of “material influence”, a manager of a person that carries on an electricity business is deemed to have a material influence over the electricity business (s 11(1)(a)); and
 - 1.4 a person is involved in an electricity business if the person has material influence over the business (section 7(1)(c)).
- 2 Therefore on his appointment to the board of Meridian, Mr Boyd would, as a result of his existing directorship of AIAL, be involved in both an electricity supply business and an electricity lines business.

SCHEDULE 4 – DETAILS OF VOTING RESTRICTIONS ON MR BOYD AS A DIRECTOR OF AIAL

- 1 AIAL is subject to the NZX Listing Rules. In the event that Meridian proposes to supply AIAL's own electricity requirements or enter into a use-of-systems agreement with AIAL, Mr Boyd would be prohibited from voting or being included in a quorum in respect of that matter, under the NZX Listing Rules as he is "interested" in the transaction in terms of the Listing Rules (Rule 3.4.3).

Rule 3.4.3 of the Listing Rules states that:

"Interested Directors: *Subject to Rule 3.4.4, a Director shall not vote in respect of any matter in which that Director is interested, nor shall the Director be counted in the quorum for the purposes of consideration of that matter. For this purpose, the term "interested" bears the meaning assigned to that term in section 139 of the Companies Act 1993...*

Rule 3.4.4 states that:

"Exception: *Notwithstanding Rule 3.4.3, a Director of an Issuer which is a company registered under the Companies Act 1993 may vote in respect of and be counted in the quorum for the purposes of a matter in which that Director is interested if that matter is one in respect of which, pursuant to an express provision of that Act, Directors are required to sign a certificate or one which relates to the grant of an indemnity pursuant to section 162 of the Companies Act 1993."*

SCHEDULE 5 – DETAILS OF VOTING RESTRICTIONS ON MR BOYD AS A DIRECTOR OF MERIDIAN

- 1 Meridian’s constitution takes a strict line on conflict matters and provides that a director may not vote on a matter relating to an interested transaction (clause 26.1) except in certain limited circumstances.

Clause 26.1 of Meridian’s constitution states:

"A director of the Company who is interested in a transaction entered into or to be entered into, by the Company may not (subject to clauses 26.1.1 and 26.2) vote on a matter relating to that transaction; but may –

26.1.1 vote on any matter to which either clauses 33 and 34 apply;

26.1.2 attend a meeting of directors at which a matter relating to the transaction arises, and be included among the directors present at the meeting for the purposes of a quorum;

26.1.3 sign a document relating to the transaction on behalf of the Company; and

26.1.4 do anything else as a director in relation to the transaction,

as if he or she were not interested in the transaction."

Clause 26.2 provides that:

"The Shareholders may suspend or relax the prohibition on interested directors voting to any extent in respect of any particular transaction by written notice signed by them to the address for service of the Company."

Clauses 33 and 34 relate to indemnity and insurance for directors and employees