



COMMERCE COMMISSION

Decision No. 503

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

EASTLAND NETWORKS LIMITED

The Commission:

Paula Rebstock
Donal Curtin

Summary of the Application:

Eastland Networks Limited, which is involved in an electricity lines business, seeks an exemption, pursuant to s 81 of the EIR Act, to be involved in an electricity supply business.

Determination:

The Commission, pursuant to s 81 of the EIR Act, exempts Eastland Networks Limited from the application of s 17 of the EIR Act in relation to a prohibited cross-involvement in an electricity supply and an electricity lines business. The exemption is subject to the terms and conditions stated in this decision.

Date of Determination:

17 July 2003

Date of Exemption:

The exemption takes effect from the date of the publication of a Notice of Exemption in the *New Zealand Gazette*.

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CONTENTS

INTRODUCTION.....	2
COMMISSION PROCEDURES	2
GENERAL.....	2
CRITERIA USED BY THE COMMISSION TO CONSIDER EXEMPTION APPLICATIONS.....	2
PARTIES.....	3
EASTLAND NETWORK LIMITED	3
THE EXEMPTION SOUGHT BY ENL.....	4
INVOLVEMENTS.....	6
PROHIBITED CROSS-INVOLVEMENT	6
EXAMINATION IN TERMS OF THE COMMISSION’S CRITERIA	6
INCENTIVES OR OPPORTUNITIES TO INHIBIT COMPETITION IN THE ELECTRICITY INDUSTRY	6
<i>Local Distribution Market</i>	8
<i>Conclusion on Incentives or Opportunities to Inhibit Competition</i>	8
INCENTIVES OR OPPORTUNITIES TO CROSS-SUBSIDISE GENERATION ACTIVITIES.....	8
<i>Conclusion on Incentives or Opportunities to Cross-subsidise</i>	9
A RELATIONSHIP NOT AT ARMS LENGTH	9
<i>Conclusion on A Relationship Not at Arms Length</i>	10
ANALYSIS.....	10
COMMISSION DECISION.....	13
NOTICE OF EXEMPTION.....	14

INTRODUCTION

1. On 10 March 2003, the Commerce Commission (“the Commission”) received an application from Eastland Networks Limited (“ENL” or “the Applicant”) for an exemption under s 81 of the EIR Act (“the Application”).
2. ENL seeks an exemption from the application of s 17 of the EIR Act in respect of potential “cross-involvements” (as that term is defined in the EIR Act) arising in relation to certain generation activities ENL wishes to undertake.
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 s 81 of the EIR Act.

COMMISSION PROCEDURES

General

4. For the purpose of considering this application for exemption, the Commission, in terms of s 58 of the EIR Act which applies s 105 of the Commerce Act 1986 to the EIR Act, has delegated its powers under s 81 of the EIR Act to Paula Rebstock, Deputy_Chair, and Donal Curtin.

Criteria Used by the Commission to Consider Exemption Applications

5. 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
6. The Commission stated in Practice Note No.3 that:

“The EIR Act provides for the Commission to make exemptions in terms of s 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 s 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 s 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 –

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

- (c) effectively separating electricity distribution from generation and retail; and
- (d) promoting effective competition in electricity generation and retail.”

7. 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 Act are met. Strict compliance with these limits and requirements is, other than in exceptional circumstances,⁽²⁾ expected.”

8. The Commission stated in Practice Note No.3 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?
- 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 market(s)³ 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.”

PARTIES

Eastland Network Limited

9. ENL is wholly owned by the Eastland Energy Community Trust (“EECT”). The Gisborne District Council (“GDC”) is the capital beneficiary of the EECT. The income beneficiaries of the EECT constitute all consumers connected to ENL’s distribution network and all rate payers on the Gisborne District Local Authority Electoral Roll.
10. ENL owns two contiguous but not interconnected electricity distribution networks which service the Gisborne and Wairoa districts with electricity lines function services. Both networks are spur lines with limited connections to the networks outside the Wairoa and Gisborne townships, due to sparse population. The Gisborne network in particular is a spur of 200km bounded in the north by Te Araroa. ENL distributes approximately 302 gigawatt-hours(“GWh”) of electricity per annum to 26,000 consumers connected to its two isolated distribution networks.
11. Pursuant to the EIR Act, ENL sold its interests in electricity supply to Contact Energy Limited (“Contact”) in November 1998.

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

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

12. ENL purchased both the lines business and generation business assets of Wairoa Power in August 1999. The generation assets consist of the Waihi Hydro Scheme (“Waihi”) which has a nameplate capacity of 4.88 megawatts (“MW”). ENL generally uses Waihi as a peaking plant, in order to reduce transmission charges. The annual generation output of Waihi is approximately 11 GWh. ENL currently sells the energy output from Waihi to Trustpower, the incumbent electricity retailer in Wairoa, at the spot price. Presently, ENL is attempting to sell its Waihi generation. [

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13. ENL also owns some containerised mobile diesel generation sets (“gensets”) for the purpose of providing security and managing outage in isolated parts of ENL’s distribution network. Prior to 2003, ENL operated a 0.5MW genset, predominantly near the township of Mahia, in order to meet peak summertime energy consumption. ENL has recently increased its genset generation capacity to a total of 3.5MW (three 1MW and one 0.5 MW gensets), and intends to purchase gensets with additional capacity of 3MW (an additional three 1MW gensets). There is an additional 1.2MW of privately owned generation in the district (owned by the GDC) which ENL also deploys as necessary to meet security needs. This combined generation is also applied to deliver acceptable security standards at transmission level where existing Transpower assets are constrained. ENL does not presently sell the electricity generated by these diesel gensets.

THE EXEMPTION SOUGHT BY ENL

14. In a letter to the Commission dated 9 June 2003, ENL amended its original application for exemption. Consequently, ENL seeks an exemption under s 81 of the EIR Act with respect to the following activities:

- i. ENL be permitted to apply 6.5MW of standby diesel generation in a peak limiting role and sell the energy generated as a consequence to electricity retailers;
- ii. ENL be permitted to offer electricity retailers its generation capability for their application to management of the wholesale electricity market costs;
- iii. ENL be permitted to operate its 4.88MW Waihi Hydro Scheme in addition to the above while it concludes a successful sale process; and
- iv. Given that the intent of regulation is to limit line company involvement in electricity supply to a 10% level and that the above capacities are related to peak demand and not base load generating capability, it is suggested that expressing limitations in GWh terms may be more appropriate for the way ENL is intending to apply its generation. A 10% limit would therefore equate to 30GWh in ENL’s case.

15. ENL intends to place four of its 1MW gensets strategically along its Gisborne network in order to assist with management of peak load, and also to provide network security during maintenance or other outages. In addition, ENL intends to allow [] to invoke the gensets when spot prices rise above [].

16. Further, ENL wishes to add the remaining two 1MW gensets to the Wairoa Network, one at Mahia. ENL also wishes to operate a further 0.5MW diesel genset as required, which ENL presently owns and occasionally operates, and to sell the resultant electricity.

17. ENL argues that it will deploy this standby generation in a peaking role during winter daily peaks. The generators will be run, as required, up to a few hours per day to limit the peak demand that ENL's aggregate system load profile presents to the national grid. ENL argues that this not only allows existing network and transmission assets to be utilised more efficiently, but that it is also a lower cost alternative than ENL would otherwise face to upgrade its network, and that of Transpower, in order to meet new capacity demands. ENL states that the costs of such an upgrade of Transpower's network would be in the order of \$30 million, while the cost of the upgrade of ENL's network would be in the order of \$10 million.

18. Whilst stating that the sale of the distributed generation is secondary to the primary purpose of the generation capacity, i.e. to avoid demand peaks, ENL argues that:

“Viability requires ENL to recover some of the cost of the generation by offering the energy for sale to retailers. However the majority of the recovery of costs is derived from avoided transmission costs and avoided new investment.

Retailers have requested that they be permitted to contract the use of the gensets during periods of high spot price. While the diesel gensets generate at costs exceeding 20c/kWh the spot price in Gisborne regularly exceeds this level. This is characteristic of the constrained transmission system and the dominance of the Genesis owned generation in the region that is located behind the transmission constraint. The deployment of ENL's generation by retailers is likely to increase competition and reduce power supply costs to the region.”

19. ENL states further:

ENL has a pricing methodology that supports the installation of distributed generation by passing through the transmission savings that the generation creates to the owners of the generation. The benefit passed through is the same to whoever owns the generation whether ENL, a retailer or an independent owner.

20. Points i-iii are considered further below. Point iv refers to s 7 of the EIR Act, which states:

“(1) For the purposes of this Act, a person is involved in an electricity business if the person –

...

(b) Exceeds the 10% threshold in s 8 in respect of that business...”

21. Section 8 states:

“A person exceeds the 10% threshold in respect of an electricity business if the person –

- (a) Has more than 10% of the control rights in the business; or
- (b) Has more than 10% of the equity return rights in the business; or
- (c) Is one of 2 or more associates who, in aggregate, have more than 10% of the control rights in the business; or
- (d) Is one of 2 or more associates who, in aggregate, have more than 10% of the equity return rights in the business.

22. The Commission considers that ENL's argument that the 10% threshold in s 7 should be interpreted in terms of GWh is incorrect. Section 8 refers solely to control and equity return rights in an electricity business, and an interpretation of the 10% threshold based on an electricity lines business's involvement in electricity supply (in GWh) is inconsistent with this section. The Commission will therefore not consider point iv further.

INVOLVEMENTS

23. ENL is the owner of an electricity distribution 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));
- is not excluded from the definition of an electricity lines business by s 4(2).

24. Therefore, ENL is an electricity lines business in terms of the EIR Act.

PROHIBITED CROSS-INVOLVEMENT

25. 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.”

26. ENL is involved in an electricity lines business and wishes to increase the amount of distributed generation on its network beyond the 5MW permissible under s 5(2)(e)(i), which will result in ENL being involved in an electricity supply business. ENL would therefore, pursuant to s 17, have a prohibited cross-involvement in an electricity lines business and an electricity supply business.

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?

The Electricity Generation and Wholesaling Market

27. The Commission has examined the incentives or opportunities (which would result from the granting of the exemption requested) for ENL to inhibit competition in the national electricity generation and wholesale market. ENL presently sells the electricity it generates from Waihi to TrustPower at spot market prices. The average annual output of Waihi is around 11GWh. ENL estimates that the combined output of the gensets will be around 3.5GWh per annum.

28. Therefore, the potential output of the generation proposed by ENL is approximately 14.5GWh annually, which represents a negligible amount (0.05%) in terms of the size of the national electricity generation and wholesaling market⁴. As such, the Commission does not consider that granting of an exemption would result in incentives or opportunities to inhibit competition in the national electricity generation market.

⁴ Based on a national generation market of 33,000-34,000 GWh per annum.

29. The Commission has also considered the incentives or opportunities (which would result from the granting of the exemption requested) for ENL to inhibit competition in the regional electricity generation market should this definition be more appropriate. The Commission noted in *Termination report – investigation into On Energy’s exit from electricity retailing, 4 November 2002*, paragraph 44:

“The generation and wholesale market is considered to be a national one. Although wholesale prices vary between nodes, the generation and transmission network connections between them ensures that none individually can be considered to constitute a separate market. Similarly, North Island prices are typically higher than South Island prices by 3-10%, reflecting the energy losses in transmitting electricity from south to north. By itself, this does not indicate separate markets in each of the Islands, nor do transmission constraints occur on a regular and predictable basis to conclude that there are separate markets. However, were transmission constraints to become more regular, predictable and/or lead to significant nodal price separations there could be cause for revisiting this assessment.”

30. In this instance, a narrower geographic market may be more appropriate if transmission constraints are sufficiently regular and predictable to conclude that the Gisborne and Wairoa networks constitute separate regional generation markets.
31. The Commission considers that it is arguable whether transmission constraints occur on sufficiently regular and predictable basis in the Gisborne and Wairoa regions to justify a regional market definition. However, even if the Commission adopted a regional market definition, the addition of the gensets would only increase the energy supplied by ENL on the Wairoa network by 2%. Presently, Waihi provides approximately 22% of the energy supplied through the Wairoa network, so the addition of the gensets on the Wairoa network would increase the amount of electricity supplied by ENL to 24%. The gensets on the Gisborne network would provide only 1% of the total energy supplied through that network. The Commission considers that the increase in generation of 2% on the Wairoa network and 1% on the Gisborne network that would occur as a result of the exemption being granted is insufficient to substantially inhibit competition in a regional electricity generation market.

The Regional Retail Market

32. Since the introduction of the EIR Act in 1998, the Commission has considered the electricity retail market to be national in geographic scope. However, recent consolidation in the national electricity retail market has drawn the geographic scope of that market definition into question. As such, for the purposes of this application, the Commission will adopt a conservative approach on the basis that if there are no competition issues in the narrower market, there are unlikely to be any in a broader national market. Therefore the market definition the Commission proposes to use for the purposes of this application is the market for electricity retailing on ENL’s electricity lines networks.
33. Having defined the market thus, ENL does not participate in this market, having sold its Gisborne retail customers to Contact Energy Limited, and its Wairoa retail customers to Trustpower.
34. Therefore, there are no incentives or opportunities for ENL to inhibit competition in this market.

Local Distribution Market

35. The local distribution market is a natural monopoly, where by definition competition is likely to be limited. Any new incentives or opportunities to inhibit competition are, therefore, likely to be related to those already present.

Conclusion on Incentives or Opportunities to Inhibit Competition

36. The Commission considers that the existing generation of 4.88MW and the proposed generation of 6.5MW, in this particular fact situation, will not create any additional material incentives or opportunities for ENL to inhibit competition in the national electricity retail market, the national or regional electricity generation and wholesaling market, or the local distribution market.

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?

37. 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 an electricity lines business could be created by:
- 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.
38. ENL anticipates that electricity generated by the gensets will be sold in two different circumstances, namely:
- When electricity is generated by ENL to avoid transmission costs or for service requirements (“the Maintenance Price”); and
 - When electricity is generated at the request of retailers when the spot price exceeds the cost of diesel generation (“the Injection Price”).

(a) [

]

39. ENL argues that the viability of generation from the gensets when used at the discretion of ENL (i.e. for electricity sold at the Maintenance Price) requires that some of the cost of the generation be recovered by offering the energy for sale to retailers at a discounted price. However, the majority of the recovery of costs is derived from avoided transmission costs and avoided new investment. Thus, according to ENL, the Maintenance Price above represents the true cost of generation less savings made through avoided transmission and new investment costs.
40. In support of its application, ENL argues that the purpose of the EIR Act, to avoid cross-subsidising uneconomic generation activities from a lines business, will not be defeated as the economic benefits of avoided transmission and new investment costs outweigh any uneconomic cross subsidisation that might occur. Furthermore, the portable nature of the gensets mean that investment is not sunk, and should the generation fail in its primary purpose (to provide solutions to network issues) or face “hard times” it is more likely to be sold than supported with further capital injection.
41. The Commission considers that both the incentive and opportunity to cross subsidise generation activities by selling electricity at a non market price is by definition present when the energy generated by the gensets is sold at the Maintenance Price, as under the EPA only a proportion of the true cost of generation will be passed on to Contact, with the balance made up of avoided lines business related charges. Furthermore, the Injection Price will represent a sale of electricity at a non-market price whenever the spot price exceeds [] per MWh – foreseeably the only period during which a retailer would request electricity from the gensets for its own purposes.
42. There is also the hazard that other cross-subsidisations of the generation activities will occur. The Commission’s criteria identifies these as:
- the incentive or opportunity to offer favourable connection terms;
 - 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.
43. Of these criteria, the Commission considers that it is possible that cross subsidisation may occur with respect to all points.

Conclusion on Incentives or Opportunities to Cross-subsidise

44. The Commission considers that the proposed generation, in this particular fact situation, will create material incentives or opportunities for ENL to cross-subsidise the generation from its electricity lines business.

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?

45. If granted an exemption by the Commission, ENL proposes to continue to own and operate both an electricity lines business and an electricity supply business. The two businesses will have common directors, managers, premises and records. ENL’s Board of

Directors and its Managers will make decisions crucial to the operation of both types of businesses, for example:

- line pricing and the price at which the output of gensets is sold to the retailers trading over ENL's electricity distribution network; and
- the allocation of electrical losses to the electricity lines or the supply business; and
- the allocation of debt and overheads between ENL's electricity lines business and the gensets.

46. ENL has submitted that the relationship between its electricity lines business and generation interests will not be at arms length. ENL contends that because of the Electricity Sale and Purchase Agreement ("EPA") it intends to institute with electricity retailers, there will be no scope for day to day negotiation with retailers on price and volume. Further, ENL submits that the sale of energy is secondary to the primary purpose of the generation to avoid peak demands, and thus the breach of the arms length rules will not defeat the purposes of the EIR Act

47. The Commission considers that ENL's argument, that because it intends to enter an EPA, the purpose of the arms length rules will not be defeated, is prima facie incorrect. As stated by the Commission in *Top Energy*⁵, the arms length rules of the EIR Act apply to all electricity generators, whether or not contractually bound in respect of electricity output and sale price. Similarly, the argument that the breach of the arms length rules will not defeat the purposes of the EIR Act because the primary purpose of the generation is to avoid peak demands is incorrect, as the arms length rules apply to all generation and lines activities, regardless of their intended purpose.

Conclusion on A Relationship Not at Arms Length

48. The Commission notes that the proposed generation, in this particular fact situation, will permit a relationship between an electricity lines business and an electricity supply business which is not at arms length.

ANALYSIS

49. The Commission notes that ENL's Application does not satisfy two of the three criteria generally adopted by the Commission in assessing EIR Act exemptions. In particular, the Application:

- fails the restriction on the cross subsidisation of an electricity supply business from an electricity lines business; and
- fails the restriction on relationships not at arms length.

50. However, ENL has provided the Commission with evidence which suggests that the counterfactual to allowing the Application is line asset upgrades to the total value of approximately \$40 million. ENL has stated that these costs will be passed to consumers connected to the Gisborne and Wairoa distribution networks in the form of increased line charges. ENL considers that the particular purpose for which it proposes to use the

⁵ Decision 353, *Top Energy Ltd*, 10 June 1999

gensets i.e. network security issues and avoided transmission upgrade costs, is in keeping with the broad purpose of the EIR Act.

51. The Commission has given careful consideration to the arguments put forward by ENL. The Commission's powers in relation to exemptions are in s 81 in Part 5 which is headed "Separation of Lines and Supply – Miscellaneous Provisions". Section 81(1) provides:

"81. Exemptions

- (1) The Commission may, **for the purposes of this Act**, in its discretion and upon such terms and conditions (if any) as it thinks fit, by notice in the *Gazette* exempt any business or involvement or interest from the application of this Act, or exempt any person from compliance with any provisions of any regulations made under this Act."

(emphasis added)

52. The key question is what "for the purposes of this Act" means in the context of the provisions of the Act which describe its purposes. These are ss 2, 27 and 60. There are two general interpretation issues:

- What are the **purposes** of the Act?
- What does "**for**" mean in that context? Does it mean no more than "consistent with" or is the Commission required to act in such a manner that the purposes of the Act are fulfilled in a more positive sense?

53. The purposes of the EIR Act are provided by s 2(1) and (2), which state:

"Section 2. Purpose-

- (1) The purpose of this 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."

(2) The particular purpose of Parts 1 to 5 (separation of lines and supply) is-

 - (a) To prohibit 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) To restrict relationships between electricity lines business and electricity supply business which may not otherwise be at arms length."

54. The Commission considers that while the interposition of the word "by" in s 2 suggests that (c) and (d) are "operative" rather than "purposive", that as a direct objective of the Act they are part of the purpose as it has been framed by Parliament. It follows that as far as possible the Commission's decisions under s 81 should be as far as possible consistent with (in particular) (c).

55. Section 2(1)(c) has though, a specific objective and the broad purposes/or effects that it is intended to achieve are set out in s 2(1)(a) and (b). In addition s 2(1)(c) states the intended effect of the primary rule in the Act (found in s 17).

56. Given that the power under s 81 has been given to the Commission to grant exemptions there may be circumstances in which the power can be exercised in relation to businesses that would otherwise be required to comply with the structural framework required by the Act.
57. It follows that there must be exceptional cases where in particular the broad s 2(1)(a) and (b) purposes can be achieved without the separation. The Commission considers that in such cases it cannot have been the intention of the legislature that at the same time (c) has to be complied with strictly.
58. The Commission considers that “for the purposes of the Act” in s 81 is to be interpreted as a positive requirement to advance the purposes of the Act. If an applicant can satisfy the Commission that it can operate in such a way that the s 2(1)(a) and (b) purposes are achieved by exemption rather than the application of the Act then there is a basis for an exemption to be granted.
59. The Commission considers that the exemption power should not be used to bypass the key policy decisions that the Act contains unless exceptional circumstances exist. An applicant would have to show that the purposes of the Act are better achieved by their business not being subject to the structural requirements than if the Act applied in the normal way.
60. In the present case, the Commission considers that the circumstances described by ENL are exceptional as the alternative to granting an exemption would mean customers on ENL’s networks would bear the cost of the required network upgrades – a cost which could be efficiently avoided by the insertion of the gensets in ENL’s distribution network. Furthermore, the addition of the gensets would increase network security. These assertions were supported other industry participants. Thus, the Commission considers that the granting of an exemption for the 6.5 MW of mobile diesel generation would be in accordance with the purposes of the Act as described in s 2(1)(a) and (b).
61. The Commission also considers that, given the impending sale of Waihi and the intended use of the generation from this asset until its sale, permitting ENL to operate Waihi in addition to the gensets while it concludes a successful sale process would not be contrary to the purpose of the Act.
62. The Commission also notes that the Minister of Energy recently made an announcement on electricity matters including dry year supply, reserves, the Electricity Commission and several other matters. Included in the announcement was the Government’s intention to:
- amend the law to allow lines companies to own reserve generation without limit and ordinary generation up to 25 megawatts or 10% of their load; and
 - regulate lines charges to encourage the development of small generation projects connected to local lines.
63. The proposed increase in ENL’s generation capacity would fall inside the anticipated amended limits (scheduled for passing in January/February 2004).
64. The Commission therefore considers that the law may change in the near future to allow an increased amount of distributed generation to be owned by electricity lines businesses and that it is entitled to take this possible law change into account when considering matters that come within the Commission’s discretion. Given the exceptional circumstances described above and the possible law change, the Commission considers that it is appropriate to exempt ENL from the application of s 17 of the EIR Act under

certain conditions that limit the duration of the exemption, ensure the rapid sale of Waihi and allow for the possible change in the law.

COMMISSION DECISION

65. In light of the broad purpose of the EIR Act as described in s 2(1)(a) and (b) and the announcement by the Minister of Energy, and having considered the stated criteria, the Commission exempts ENL from the application of s 17 of the EIR Act with respect to:

- its proposed 6.5 MW of mobile diesel generation; and
- Waihi, while it concludes a successful sale process for Waihi (in accordance with point iii of the requested exemption),

subject to the terms and conditions specified in the Notice of Exemption.

66. In addition, the Commission considers there will be minimal detrimental effect on generation or retail market competition if ENL offers electricity retailers its generation capability for their application to management of the wholesale electricity market costs, and thus ENL may offer the gensets to electricity retailers for this purpose (as requested in point ii of the requested exemption).

67. The Commission has considered whether the arms length provisions of Schedule 1 of the EIR Act are relevant but, on balance, and on the facts of this particular application, considers that the limited duration of the exemption and the proposed legislative change mean that, in these circumstances, the purpose of the EIR Act will not be defeated by non-compliance with the arms length rules.

NOTICE OF EXEMPTION

The Commission, pursuant to s 81 of the Electricity Industry Reform Act 1998 (“the EIR Act”), exempts Eastland Network Limited from the application of s 17 of the EIR Act in relation to a prohibited cross involvement in an electricity supply business, comprising 6.5 megawatts of containerised mobile diesel generation sets and 4.88 megawatts of generation from the Waihi Hydro Scheme.

The exemption is subject to the following terms and conditions:

- (1) Eastland Networks Limited will continue to use all reasonable endeavours to cease their involvement in the Waihi Hydro Scheme by securing the prompt sale of the Waihi Hydro Scheme.
- (2) Eastland Networks Limited will provide the Commerce Commission with monthly written reports beginning one month after the date of this decision on the progress it is making to achieve compliance with (1) above.
- (3) The exemption expires at the earlier of midnight on 17 July 2004 or the date at which the proposed legislative changes with respect to the increase in distributed generation from 5 megawatts to 25 megawatts permitted under s 5(2)(e)(i) of the Electricity Industry Reform Act 1998 announced by the Minister of Energy come into force, unless any variation or earlier revocation in terms of s 81(5) occurs.

The Commission may vary or revoke this exemption in accordance with s 81(5) of the Electricity Industry Reform Act 1998.

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

Dated this 17th day of July 2003

Paula Rebstock
Acting Chair