

5 October 2015

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Attention: Part 3 Notices
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APPLICATION FOR PART 3 EXEMPTION - DR PATRICK STRANGE

Application

1. Under section 90(1)(b) of the Electricity Industry Act 2010 ("**Act**"), this application is made to the Electricity Authority ("**Authority**") for exemption from compliance with sections 75, 77, 78, 79 and 88 under Part 3 of the Act.

Details of the Person Filing the Application

2. This application is made by Auckland International Airport Limited ("**AIAL**") on behalf of Dr Patrick Strange ("**Dr Strange**"). It is not intended that this proposed exemption would extend to the AIAL Board more widely than Dr Strange.
3. Please direct any correspondence relating to this application to Craig Shrive (Partner) and Christopher Graf (Senior Associate) at Russell McVeagh in the first instance. Contact details are:

Russell McVeagh
Vero Centre
48 Shortland Street
PO Box 8
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Craig Shrive - 09 367 8855
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Christopher Graf - 09 367 8104
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Confidentiality

4. The fact and content of this application are not confidential.

Timetable

5. AIAL intends to recommend to shareholders the appointment of Dr Strange to its Board of Directors on, and with effect from, 22 October 2015. Accordingly, we would be grateful if the Authority could provide its decision on this

application as soon as possible. If the Authority anticipates reaching a decision in this timeframe is not likely to be possible, we should be grateful if you could let us know at first opportunity.

Background to Application

6. Dr Strange is currently, and will continue to be, a director of Mighty River Power Limited ("**MRPL**").
7. AIAL wishes to appoint Dr Strange to its Board of Directors as an independent non-executive director. Given he is currently (and will remain) a director of MRPL, as outlined in further detail below, an exemption from certain provisions of Part 3 of the Act will be required.
8. We note and rely on the Authority's Decision No. 1 ("**Decision No. 1**") dated 30 April 2012, where a director of AIAL (Mr James Miller) was exempted from provisions in Part 3 of the Act for his proposed appointment to the MRPL Board. Like with the present case, that exemption resulted in AIAL and MRPL having two common (exempted) directors.¹ Given the similarities between the two applications, the reasoning of the Authority in Decision No. 1 is, in our view, applicable here.
9. We further note that the Commerce Commission, in Decision No. 676 dated 31 July 2009, granted exemption to allow Ms Joan Withers to serve on both AIAL and MRPL Boards. This Decision informed the Authority's decision regarding Mr Miller, so we do not refer to it in detail in this application.

Parties

AIAL

10. AIAL owns and operates Auckland Airport. AIAL provides the infrastructure to support and facilitate a range of aeronautical services including leisure and business aircraft travel and freight movement. In addition to its aeronautical activities, it provides a wide variety of retail, commercial and customer services.
11. AIAL is listed on both the NZX and ASX exchanges. Its largest shareholder is Auckland Council Investments Limited (through its wholly-owned subsidiaries, Airport Shares (Auckland) Limited and Airport Shares (Manukau) Limited).
12. AIAL owns the 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's citywide network at the perimeter of the airport.
13. Accordingly, AIAL is registered with the Authority as a line owner, distributor and reconciliation participant. It distributes electricity to 384 consumers at the airport on lines (not being lines that are part of the national grid). Because AIAL distributes over the 5GWh threshold for a 'distributor' under clause 2(c) of Schedule 2 of the Act, it is deemed to be a distributor.

¹ Ms Joan Withers was already a director of both AIAL and MRPL (and subject to exemptions granted by the Commerce Commission in Decision No. 676) when the Authority granted exemption to Mr Miller in Decision No.1.

MRPL

14. As the Authority is aware, MRPL is an electricity generator and retailer.
15. In terms of its generation activities, MRPL owns or part-owns nine hydro-electric power stations on the Waikato River, five geo-thermal stations and a gas-fired station at Southdown (intended to be closed at the end of 2015).
16. Mercury Energy, MRPL's electricity and gas retail arm, retails electricity in various regions of New Zealand.
17. Mercury Energy supplies electricity to various consumers on the AIAL distribution network. However, Mercury Energy does not supply electricity to AIAL itself.

The nature of the involvement

18. Section 74 of the Act provides that a person is "involved" in a distributor, a generator or a retailer if the person:

"(c) has material influence over a business that does any of those things [distribution, generation or retail]."

19. Clause 7 of Schedule 2 of the Act defines "material influence" as being:

(1) Without limiting the ordinary meaning of the expression **material influence**, the following people are deemed to have material influence over a business:

(a) a director or manager of a person that carries on the business:

20. Therefore, on the basis of the Authority's view in Decision No. 1, upon his appointment to the Board of AIAL, for the purposes of the Act, Dr Strange would be involved in both a distributor (AIAL) and a generator (MRPL).
21. However, as explained below, to the extent that Dr Strange is involved in both companies, that involvement will not inhibit competition in the electricity industry.

Particular sections of Part 3 in respect of which an exemption is sought

22. Part 3 of the Act applies to Dr Strange as follows:

Section 75

23. Section 75 prohibits a person who is involved in a distributor from being involved in a generator. A person who is involved in distribution must not be involved in a generator that has a total capacity of more than 250MW, which is generated by one or more generating plants that are directly connected to the national grid.
24. MRPL's electricity generation capacity, comprising hydro, geothermal and gas-fired power stations, is 1644MW. This generation is directly connected to the national grid. Consequently, section 75 is applicable.

Section 76

25. Section 76 does not apply because:
- (a) MRPL does not have 50 MW of generation that is connected to AIAL's network, meaning it is not a "connected generator"; and
 - (b) MRPL does not retail more than 75 GWh of electricity in a financial year to customers who are connected to AIAL's network, meaning it is not a "connected retailer" for the purposes of this section.

Sections 77 to 79 and 88

26. Sections 77 to 79 and section 88 of the Act apply to each director of a distributor in respect of which there is either a "connected retailer" or a "connected generator" (as defined in section 77).
27. MRPL is not a connected generator because it does not have any generation connected to AIAL's distribution network.
28. MRPL is, however, a connected retailer for the purposes of sections 77 to 79 and 88 of the Act. This is because, through its retail brand Mercury Energy, MRPL retails more than 5GWh of electricity to customers connected to AIAL's network. As such, sections 77 to 79 and 88 of the Act would apply to Dr Strange upon appointment to the Board of AIAL.
29. As relevant, those sections provide:
- (a) *section 77*: every director of a distributor, where there is a connected retailer, must ensure that the distribution business has a comprehensive, written use-of-systems agreement, and that the terms of that agreement satisfy certain requirements;
 - (b) *section 78*: a distributor and a connected retailer must not pay, or offer to pay, any consideration to a retailer in respect of the transfer to a connected retailer of any retail customers who are connected to the distributor's networks;
 - (c) *section 79*: a director of a distributor must ensure that any rebates or dividends do not discriminate between customers of a connected retailer and customers of other retailers where those customers are connected to the distributor's networks; and
 - (d) *section 88*: each director of a distributor referred to in section 77(1) to ensure that the distributor discloses the quantity of electricity sold each financial year by connected retailers to customers who are connected to its local network.
30. Therefore, pursuant to section 90(1)(b), this application seeks, on behalf of Dr Strange, exemption from compliance with the following provisions of the Act:
- (a) section 75;
 - (b) section 77;
 - (c) section 78;

- (d) section 79; and
- (e) section 88

31. Dr Strange is a suitable candidate for exemption from compliance with the above provisions of Part 3. Exemption from compliance with the aforementioned sections of the Act will not inhibit competition in the electricity industry and nor would it be contrary to the purpose of Part 3 of the Act or the Authority's objective set out in section 15 of the Act.
32. Finally, we note that in Decision No.1, the Authority granted exemption from compliance with the same provisions for Mr Miller (the director involved in both AIAL and MRPL), but that this exemption did not apply to the remaining directors of AIAL and MRPL. For the avoidance of doubt, in light of the position reached by the Authority in that case, exemption is not sought for the remaining directors of AIAL (other than Mr Miller who is exempt pursuant to Decision No. 1). Those other directors will continue to comply with sections 77 to 79 and 88 of the Act.

Conditions

33. The exemption granted in Decision No. 1 was granted with conditions. While we do not consider that any competition issues would arise from Dr Strange's appointment to the AIAL Board, consistent with the approach adopted by the Authority in Decision No. 1, we propose that the same conditions be applied to Dr Strange in this application.
34. Accordingly, while a director of both AIAL and MRPL:
 - (a) Dr Strange will not participate in any discussions or decision-making by AIAL and/or MRPL regarding matters that relate to or could affect or favour the supply of electricity by MRPL (or disadvantage any other business selling electricity on AIAL's network other than MRPL) on AIAL's electricity distribution network or the provision of electricity lines services by AIAL to MRPL, including:
 - (i) the selection of, and any negotiation with, any electricity retailer for the supply, or intended supply, of electricity to AIAL; and
 - (ii) the supply, or intended supply, of electricity by MRPL to any new or existing consumers on AIAL's electricity distribution network;
 - (b) Dr Strange shall not disclose the outcome of any discussions or decision-making by AIAL to MRPL (and vice-versa) on those matters above;
 - (c) Dr Strange will confirm to the Authority, in writing, that the cross-involvement to which this exemption applies has ceased within one calendar month of the cross-involvement ceasing to exist; and
 - (d) This exemption is specific to the cross-involvements created through Dr Strange's involvement in AIAL and MRPL. It does not extend to any other interest or future cross-involvement of Dr Strange.

The relevant markets in the electricity industry

35. In Decision No. 1 the Authority was of the view that the markets relevant to that application (which in all material respects is the same as that now being made) were:
- (a) the national electricity wholesale market;
 - (b) the electricity retail market corresponding with AIAL's network; and
 - (c) the electricity distribution market corresponding with AIAL's network.
36. That being the case, those markets are adopted as the relevant markets for the purpose of this Application.

The nature of any incentives or opportunities created

Electricity Retail Market

37. Consistent with the approach adopted by the Authority in Decision No. 1 (which, in turn, was consistent with prior Commission decisions²), the focus of the Authority's enquiry in relation to electricity retail should be on AIAL's distribution network - ie MRPL airport customers connected to AIAL's network.
38. As the Authority concluded in Decision No. 1, any opportunity for competition to be affected arising out of Dr Strange's appointment to the AIAL Board will be effectively addressed by the limitations imposed on his participation in matters that relate directly to electricity supply or lines services between MRPL and AIAL. Such limitations include:
- (a) the condition proposed at paragraph 34(a) above means that Dr Strange will not have any involvement in any discussions about the terms and conditions of the use-of-systems agreement between AIAL and MRPL/Mercury Energy. As such, there will be no opportunity for Dr Strange to favour MRPL relative to other retailers; and
 - (b) clause 2.11 of the AIAL Board Charter provides that a Director who finds themselves in a conflict between their appointment to the board of AIAL and an involvement in another organisation will "*put in place appropriate processes, including excluding themselves from discussions in respect of such businesses, to ensure that the effect of such conflict of interest is minimised.*"
39. Therefore, exempting Dr Strange from compliance with the relevant provisions of the Act will not inhibit competition in the electricity industry.

National Electricity Wholesale Market

40. MRPL's generation assets are not directly connected to AIAL's distribution network, and there are no plans to have them connected in the future. As such, granting the exemption sought will not create incentives or opportunities to inhibit competition in the national electricity wholesale market.

² See, for example, the decision issued by the Commerce Commission in Decision No. 676 in respect of Joan Withers' application for exemption from section 17(2)(b) of the Electricity Industry Reform Act 1998.

Electricity distribution market corresponding to AIAL's network

41. As the Authority noted in Decision No.1, because AIAL's network is a local natural monopoly, granting of the exemption cannot affect the level of existing competition or the scope for potential competition within this market. As a result, the granting of this exemption will not create incentives or opportunities to inhibit competition in this market.

Would the exemption permit any involvement in a distributor and a generator or a retailer that may create incentives or opportunities to inhibit competition in the electricity industry?

42. For the reasons set out above, the proposed exemption, together with the conditions proposed by the applicant, will not create any incentives or opportunities to inhibit competition in the electricity industry.

Would the exemption, in respect of an involvement, create incentives or opportunities for a distributor to cross-subsidise the connected generator or a directly connected generator of over 250MW?

43. The Authority noted in Decision No. 1 that MRPL has no generation directly connected to AIAL's network, meaning that it is not a connected generator. There is no proposal for MRPL to connect any future generation assets to AIAL's network. Therefore, granting Dr Strange an exemption from compliance with sections 75, 77 to 79 and 88 of the Act, subject to the proposed conditions, would not give rise to incentives or opportunities for a distributor to cross-subsidise a connected generator.
44. Further, the proposed conditions to the exemption prevent Dr Strange from participating in any future discussions or decision-making that relates to, or has the potential to affect or favour, the retail of electricity by MRPL on AIAL's network or the provision of electricity lines services to MRPL.

Would the exemption, in respect of an involvement, permit a relationship between a distributor and a retailer or generator which is not at arm's-length?

45. The provisions on arm's length rules in section 76 and Schedule 3 of the Act do not apply:
- (a) MRPL is not a "connected generator" as its generation is not connected to AIAL's distribution network; and
 - (b) MRPL is not a "connected retailer" as it does not retail more than 75GWh of electricity to customers connected to AIAL's distribution network.
46. In any event, the conditions proposed at paragraph 34(a) above mean that any relationship would remain at arm's length.

Declaration

47. Please find **attached** to this application a Declaration completed by Dr Patrick Strange in the prescribed form.
48. Please do not hesitate to contact us if you have any questions or if any part of this application requires explanation.

Declaration

THIS APPLICATION is made by:

Patrick Clifford Strange

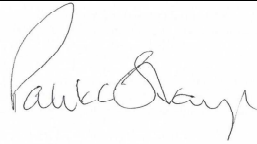
I hereby confirm that:

- all the information requested by the Electricity Authority is provided;
- all relevant information known to the applicant is provided; and
- all information provided is true and correct as at the date of this application.

I undertake to advise the Authority immediately of any material change in circumstances relating to the application.

Date: 5 October 2015

Signed by:



Patrick Clifford Strange