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The Electricity Authority
P O Box 10641
Wellington 6143

APPLICATION FOR EXEMPTION FROM ARM'S-LENGTH RULES: TOP ENERGY LIMITED

On 11 July 2017, the Authority published its draft decision paper in respect of the above application for exemption. Top Energy makes the following comments and submissions in respect of that draft decision paper.

Outline of submissions

1. The Authority proposes to grant the exemptions applied for in respect of the expansion of 32 MW to the Ngawha Springs Power Station taking its name plate generation capacity to 65 MW. Top Energy supports the proposed issuing of the exemption but not the imposition of condition (e).

2. Top Energy makes no comment in respect of proposed conditions (b), (c) and (d), noting that condition (c) was a condition upon which its application was made.

3. The constraint arising out of the Authority's proposal to grant the exemption for a period of 10 years only is inappropriate for the following reasons:
   (a) resource consents enabling geothermal fluid extraction are held for a period of 35 years;
   (b) a period of 10 years is insufficient to provide Top Energy with an acceptable return on investment;
   (c) there are existing statutory powers enabling the Authority to review the operation of the exemption in the event of any changes to the electricity industry which affect the basis on which the Authority made its decision;
   (d) the uncertainty over whether a further exemption would be granted means that directors will have to question whether it is prudent to proceed with the expansion given the potential for there to be at least a further $20 million of separate management overhead cost to be attributed to the project (based on today's dollars). In determining the economics of the expansion, directors have no choice but to take into account these additional costs; and
   (e) the limited nature of the exemption period in the context of the resource consents held and the risk of additional overhead cost essentially forces Top Energy, if the project is to proceed, to either incur the additional separate management overhead cost or, depending on the economics at the time, undertake considerable capital expenditure to connect the generation to the national grid and thus avoid the application of the corporate separation and arm's-length rules. This will result in increased transmission charges for the electricity consumers in the Far North

through limited RCPD saving or savings in the proposed Transmission Pricing Methodology either as proposed by Transpower or the Electricity Authority.

Exemption period of 10 years only

4. Top Energy has received 35-year resource consents. It has calculated its return on investment on the basis of the life of plant which in general terms equates to the period of the resource consents. On the basis of a 30+-year investment period, the plant provides an acceptable return on investment. Given the proposed 10-year condition, the investment may not provide an acceptable return given that it will be necessary, for the purposes of considering return on investment, to assume the additional separate management overhead or other costs will be incurred at the conclusion of the 10-year period. Given that the plant and connecting lines will have been built by this time, there is very limited opportunity to avoid these costs.

5. Top Energy does not accept that the condition is necessary at all. The Authority already refers to its ability, under the provisions of section 90 (5) of the Electricity Industry Act (Act), to vary or revoke the exemption. Top Energy submits that should conditions change in the electricity industry during the period covered by the exemption (which appears to be the basis upon which the authority has determined that a 10-year condition is necessary), the existing statutory provisions provide a much more appropriate and more than adequate basis on which the exemption could be reconsidered by the Authority. In particular, section 90(5) expressly provides for the variation of an existing consent and this is a more than adequate basis on which any major changes in the electricity industry which adversely impact on the market analysis undertaken by the Authority in respect of this application, can be addressed.

6. In addition, as also referred to by the Authority, there are significant regulatory controls on the behaviour of Top Energy and NGL in the context of common ownership and management. As noted in paragraph 8.4 of the draft decision paper, the pecuniary penalty regime provided for in Section 80 of the Act deals with compliance matters and therefore compliance is not a matter that needs to be considered or addressed in any conditions attached to an exemption.

7. It is noted that if the expansion were to proceed on the basis of an exemption limited to 10 years, the Authority is, in essence, forcing Top Energy, to risk either incurring at least $20 million in additional separate management overhead cost (which reflects todays costs and may not be sufficient to meet such costs in 10 years' time) or incurring considerable expenditure in connecting the Ngawha plants to the national grid. If the latter, the construction of required transmission lines will incur significant costs. As the generators will now be grid connected this will also result in increased transmission charges for the electricity consumers in the Far North through limited RCPD reduction or savings in the proposed Transmission Pricing Methodology either as proposed by Transpower or the Electricity Authority.

8. In the context of the Authority's objective under section 15 of the Act, it is difficult to see how such a cost outcome could be said to be for the long-term benefit of consumers. If the expansion is embedded it will enhance the reliability of supply in the Far North and the efficient operation of electricity industry in that region, and with the benefit of the

exemption (given there are no adverse market or behaviour consequences) provide significant long-term benefit for the consumers of the Far North from a security of supply perspective and a cost of delivered electricity perspective.

9. If Top Energy was to proceed with the expansions and there is a 10-year condition to the exemption it will initially connect that generation to its network. In doing so it will incur considerable cost. If the exemption is not extended beyond the 10-year period (noting that construction times mean the plant will not become operational until mid-2020 so the exemption in effect lasts less than 7 years), it will then have to either pay increased separate management overhead costs or, depending on the costs of separate management at the time, incur significant additional costs in constructing a line enabling the Ngawha plant to be connected to the national grid. The substantial residue of the initial expenditure in connecting Ngawha to the Top Energy network will have therefore been wasted.

10. For these reasons, Top Energy submits that the Authority should not attach a 10 year, or any time -related, condition to the exemption.

11. In Top Energy's submission, given:
    (a) the exemption sought relates to 2 (of the 15) arm's-length rules only;
    (b) the Act expressly authorises the Authority to review and revoke exemptions;
    (c) the statutory enforcement regime;
    (d) the other arm's-length rules and particularly those that relate to the behaviour of directors and management will apply

    there is no need for the Authority to restrict the period of the operation of the exemption.

12. Top Energy will be pleased to discuss these submissions.

Yours faithfully

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