



COMMERCE COMMISSION DECISION NO. 369

Determination pursuant to the Commerce Act 1986 in the matter of an application for authorisation of restrictive trade practices. The application is made by:

TRANSPOWER NEW ZEALAND LIMITED

The Commission: Dr K M Brown
E C A Harrison
P R Rebstock

Summary of Application: Transpower New Zealand Ltd has applied for authorisation of

- An agreement between Transpower New Zealand Ltd and users of the national high voltage electricity transmission grid (the grid), some of whom may be competitors in electricity markets, to come together to decide how the common elements of quality of electricity transmitted over the grid, and certain matters ancillary to these, are to be determined (the Agreement);
- An arrangement under which rights (which may be assignable) are allocated to parties based on their past, or in some cases prospective, generation or consumption of electricity (or where such rights are not allocated or assigned, allocated to the reconciled entity), to elect a committee and to do all or any of specified items (the Overall Arrangement);
- An arrangement between parties to the Overall Arrangement and the Common Quality Co-ordinator (CQC) to the extent that the arrangement does all or any of specified items;
- Individual arrangements (whose contractual form will be security contracts) between the CQC and each entity connected to the national grid, or whose actions may affect the common elements of quality, and between the CQC and Transpower as grid owner, to the extent that the security contracts oblige each such entity to do all or any of specified items; and
- Arrangements between the CQC and the grid owner which oblige the grid owner to use reasonable endeavours to ensure that each person connected to its network enter into a security contract with the CQC to the extent necessary to maintain the common elements of quality determined under the Overall Arrangement. (The arrangements under the last three bullet points are collectively referred to as the Related Arrangements).

Determination: Pursuant to sections 58 and 61(1)(a) of the Commerce Act 1986, the Commission determines to grant an authorisation to the application by Transpower New Zealand Ltd relating to the Agreement, the Overall Arrangement and the Related Arrangements.

Date of Determination: 13 August 1999

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THE APPLICATION

1. The Commission registered on 28 May 1999 an application for authorisation of restrictive trade practices from Transpower New Zealand Ltd (Transpower). The Commission's powers to authorise restrictive trade practices are provided for in section 58 of the Commerce Act 1986 (the Act).
2. The current application supersedes the application registered by the Commission on 2 October 1998 (the October 1998 application). A Draft Determination was released on that application on 13 November 1998. The application was subsequently withdrawn. Changes were made to the proposed grid security arrangements and the current application submitted to the Commission.
3. In terms of sections 58(1), 58(2), 58(5), and 58(6), Transpower has sought authorisation of
 - the Agreement;
 - the Overall Arrangement; and
 - the Related Arrangements.
4. The Agreement, the Overall Arrangement and the Related Arrangements are collectively referred to in this Determination as 'the Proposal' and are described more fully below.
5. In this Determination any reference made to grid security should be taken to refer to common elements and levels of quality of electricity transmitted over the grid. The arrangements for which authorisation is sought all concern common elements of security of electricity supply which affect all grid users. It is intended that those elements of security of electricity supply which affect only single or small groups of grid users will be dealt with in a bilateral fashion between the grid user(s) and Transpower as at present.

Background to the Proposal

6. On 4 September 1997 the Government, through the Ministers of Finance, State Owned Enterprises and Energy reached agreement¹ with Transpower to revise Transpower's Statement of Corporate Intent so that "Transpower is required to provide services (including grid security) at a level and quality determined by its customers." The Ministers stated that the

"changes are intended to:

 - enable Transpower's customers to make tradeoffs between alternative grid security standards and Transpower's prices for each level of service, which are to be consistent with the Government's section 26 policy statement on electricity transmission; and
 - ensure that the consequences of poor decisions in determining grid security standards rests with Transpower's customers."

¹ Government Policy Statement, Electricity Transmission Grid Security, made by the Ministers of Finance, State Owned Enterprises and Energy on 4 September 1997.

7. The Statement of Corporate Intent states that Transpower should strive to make services contestable wherever possible and that Transpower should be
- “Providing services at a quality and quantity that are demanded through a process of agreement with customers of those services, where:
- Customers make the trade-off between:
- alternative levels of service; and
- Transpower’s prices for each service level....
- The trade-offs are to be made by an appropriate majority of customers, where the services are shared in use.....”
8. The Ministers’ “guiding principles for developing the new grid security policy” are:²
- “The Grid Security Policy should be consistent with the Government’s overall energy policy objective which is to ensure the continuing availability of energy services, at the lowest cost to the economy as a whole, consistent with sustainable development.
- The Grid Security Policy should ensure the efficient use of resources in providing services at a quality and quantity that are demanded by the grid users.
- Where there are substitute supplies of security products, the Grid Security Policy should not be biased in favour of any one type of provider.
- Grid users should be responsible for selecting the quality and quantity of services for which they are willing to pay. These demanded services should be priced in a manner consistent with the Government’s pricing principles for electricity as outlined in any statement of economic policy relating to electricity transmission issued from time to time under section 26 of the Commerce Act 1986 to the Commerce Commission.
- The consequences of poor selection of security standards should rest with grid users.
- While recognising the shared benefits of the network, the Grid Security Policy should (subject to principle 2) allow the development of customer specific solutions to the demand and supply of security products.
- The process by which the Grid Security Policy evolves should be transparent and not provide bias towards any person and, in particular, should limit the potential for any person to amend the policy in a manner which introduces unjustifiable bias.
- The Grid Security Policy should be enforceable and binding on all parties.”
9. The Interim Grid Security Committee³ (IGSC) was to make recommendations to Transpower’s Board of Directors concerning a suitable governance structure to meet the Ministers’ guiding principles. Such recommendations have been made and accepted by Transpower and are now the subject of this application for authorisation.

The Agreement

10. The applicant seeks authorisation for an Agreement between Transpower and users of the national high voltage electricity transmission grid, some of whom may be competitors in electricity markets, to come together to decide how the common elements of quality of electricity transmitted over the grid, and certain matters ancillary to these, are to be determined.

² Extract from the Government Policy Statement on Electricity Transmission Grid Security.

³ The Interim Grid Security Committee was formed by Transpower to develop and begin the process by which the new grid security policy would evolve.

The Overall Arrangement

11. The applicant also seeks authorisation of the Overall Arrangement (currently in the format of the Multilateral Agreement on Common Quality Standards (MACQS) between users of the grid and Transpower under which rights are initially allocated to parties based on their past, or in some cases, prospective generation or consumption of electricity, to elect a committee and to do all or any of the following (either through the committee or by passing a resolution with a required majority of up to 75% of votes cast):
 - decide the common elements of quality;
 - appoint a CQC to provide or acquire services necessary to maintain the common elements of quality;
 - decide performance objectives for the CQC;
 - decide technical and performance standards (where technical and performance matters affect the common elements of quality) for entities forming or connecting to the national grid or whose actions may affect the common elements of quality;
 - make provision for dealing with non-compliance with those technical and performance standards;
 - decide arrangements for ancillary services relevant to the maintenance of common elements of quality. (For example, this could involve the CQC acting in a purchaser of last resort role as well as coordinating the overall dispatch of ancillary services.);
 - decide a methodology for allocating the costs of maintaining particular levels of the common elements of quality;
 - make provision for a disputes resolution process for disputes relating to the common elements of quality;
 - provide a mechanism for amending the Overall Arrangement that provides for the CQC's consent to be obtained for any changes except to the governance structure. Any amendment to the Overall Arrangement would be mirrored in an amendment to the arrangement between the CQC and the parties to the Overall Arrangement, described below.
12. The rights allocated to generators and consumers of electricity may be transferred by the generator or consumer to another person for the purpose of the arrangement. If no transfer or allocation of those decision rights is made, then the party which is responsible for reconciliation of their information will obtain the decision rights.
13. The Overall Arrangement (at the level of generality described above) prescribes how individual decisions relating to the common elements of quality and certain ancillary matters will subsequently be made. The applicant does not seek authorisation for the content of any of these individual decisions which themselves will continue to be subject to the provisions of Part II of the Act (unless themselves authorised following further application in the particular case).
14. An industry committee, the Grid Security Committee (GSC), will be created and will comprise 10 people:

- Three of whom will be elected by generators participating in the collective arrangements;
 - one elected by retailers participating in the collective arrangements;
 - one person representing grid owners, appointed by Transpower;
 - one person representing distribution businesses, appointed by the Electricity Network Association (ENA);
 - one person representing small consumers, appointed by the Consumers' Institute;
 - one person representing major industrial users, appointed by the Major Electricity Users' Group (MEUG);
 - one person representing commercial users appointed by the New Zealand Chambers of Commerce; and
 - an independent chair appointed by the other nine members of the GSC.
15. A person nominated for the GSC as a representative of generators or retailers must demonstrate a nominal level of support (nominations to be supported by parties with a total of at least 1% of the generator or retailer votes respectively). At any time, parties holding 5% or more of the votes could cause a vote to be held to decide whether all GSC members should be removed. If 75% or more of those who vote support the motion, a new committee would be appointed.
16. The application states that the GSC will adopt the following voting procedure in establishing MACQS, and in dealing with future proposals to change any common element of electricity transmitted over the grid:
- the GSC would be required to make available details of any proposal it is considering;
 - the GSC would be required to ensure that all affected parties are given reasonable opportunity to put their views and that their views are fairly and reasonably taken into account;
 - the GSC would be required to ensure that all relevant and material information relating to the proposal is considered;
 - the GSC would be required to ensure that the costs and benefits resulting from implementing the proposal would be allocated reasonably;
 - following publication of the GSC's draft recommendations, a minimum period of 20 working days would be allowed for industry to make submissions. This period could be extended for complex issues;
 - if, after considering all relevant and material information, two or more committee members oppose the change the proposal would lapse. The committee would publish its decisions and reasoning;
 - a decision to proceed with a change will be implemented unless parties holding 5% or more of eligible votes request a vote be held; and
 - a majority of 75% of votes cast would be required for a change to be implemented.

17. MACQS includes the provision that Transpower (or a wholly owned subsidiary) will be the initial CQC. It also states that Transpower must agree before any changes are made to the final form of MACQS. However any disagreement is subject to the dispute procedures in MACQS. MACQS provides that a review will be conducted by 31 December 2002 to consider the nature of the CQC's role and whether it is feasible that the role can be performed by a person other than Transpower. The CQC role will not be made contestable unless Transpower agrees that it should.

The Related Arrangements

18. The applicant also seeks authorisation of the three Related Arrangements. The particulars of each arrangement are described in turn.

Arrangement Regarding the Common Quality Co-ordinator

19. The applicant seeks authorisation of an arrangement between parties to the Overall Arrangement and the CQC to the extent that the arrangement does all or any of the following:
- obliges the CQC (which initially will be Transpower) to provide or acquire services necessary to maintain the common elements of quality decided under the Overall Arrangement;
 - commits the CQC to performance objectives decided under the Overall Arrangement;
 - provides that the CQC will enter into security contracts (see paragraph below) with the entities forming or connected to the national grid or whose actions may affect the common elements of quality; and
 - provides a mechanism for amending this arrangement by agreement between the parties.

Individual Arrangements

20. The applicant seeks authorisation of individual arrangements (whose contractual form will be security contracts) between the CQC and each entity connected to the national grid or whose actions may affect the common elements of quality, and between the CQC and Transpower as grid owner, to the extent that the security contracts oblige each such entity to do all or any of the following:
- comply with the technical and performance standards from time to time decided under the Overall Arrangement;
 - be subject to any provision under the Overall Arrangement for dealing with the non-compliance with those technical and performance standards;
 - pay the costs of maintaining the common elements of quality that have been allocated to that entity under the methodology determined under the Overall Arrangement; and
 - have disputes under the security contract resolved in accordance with the dispute resolution process decided under the Overall Arrangement.

21. These individual arrangements will take the form of bilateral contracts between the CQC and each entity whose actions may affect the common elements of quality. The details of these contracts will have to be negotiated between the parties. Thus the Proposal does not guarantee that any collectively determined change to common quality standards will be able to be adopted.

Arrangements Between the CQC and the Grid Owner

22. The applicant seeks authorisation of arrangements between the CQC and the grid owner which oblige the grid owner to ensure that each person connected to its network enters into a security contract with the CQC to the extent necessary to maintain the common elements of quality determined under the Overall Arrangement.

Not Subject of the Application

23. The applicant does not seek authorisation of:
- transmission availability and pricing;
 - particular common elements of quality from time to time decided under the Overall Arrangement;
 - particular performance obligations from time to time decided under the Overall Arrangement;
 - particular technical and performance standards from time to time decided under the Overall Arrangement;
 - particular sanctions from time to time decided under the Overall Arrangement for the non-compliance with those technical and performance standards;
 - contracts between the CQC and providers of ancillary services, and price offers by suppliers of ancillary services;
 - particular methodologies from time to time decided under the Overall Arrangement for allocating the costs of maintaining the common elements of quality;
 - the appointment of particular mediators or arbitrators to determine disputes regarding the Overall Arrangement;
 - any particular dispute resolution procedure from time to time decided under the Overall Arrangement;
 - contracts for higher levels of quality between the CQC and individual users;
 - the administration of the committee whose members are appointed or elected under the Overall Arrangement; and
 - particular decisions from time to time relating to the contestability of the CQC's role.

Changes since the previous application

24. The principal changes which have been made to the arrangements since the October 1998 application are:

- Guiding principles have been introduced.
- The allocation of decision rights has been altered.
- The composition of the Grid Security Committee is changed.
- The provision relating to the review of the contestability of the CQC function now specifies that the review must be carried out jointly by the GSC and the CQC and that the outcome of the review must be the subject of agreement between the entities.

COMMISSION PROCEDURES

25. The Commission identified fifty three parties who had an interest in the application and these parties were provided with the material provided by Transpower in support of its application.
26. The fact of the application was advertised in metropolitan newspapers on 5 June 1999. No responses were received as a result of the advertising.
27. On 30 June 1999, the Commission issued a Draft Determination giving its preliminary view that the public benefit from the Proposal would outweigh any detriment, and that the Commission would grant an authorisation pursuant to section 61(6) of the Act.
28. The Commission also identified a number of issues in the Draft Determination about which further information and comment was sought.
29. Section 62(5) of the Act provides that any of the persons to whom the Draft Determination is sent may notify the Commission that he or she wishes the Commission to hold a conference prior to making a determination on an application for an authorisation under section 58 of the Act. Todd Energy Limited (Todd) notified the Commission under this section. Hence the Commission held a conference in Wellington on 28 July 1999 to assist in its consideration of the application.

THE APPLICANT

30. Transpower is a State Owned Enterprise. It was formed as a result of the separation of the generation and transmission assets of the Electricity Corporation of New Zealand Limited (ECNZ) on 1 July 1994.
31. Transpower is the owner and operator of the high voltage national electricity grid. It has two roles:
 - management of the high voltage alternating and direct current assets which comprise the national grid. Transpower's asset management role is not relevant to this application except that ownership of the assets empowers Transpower to insist on certain technical standards and operating requirements from those parties which it allows to connect to the grid; and
 - operation of the national grid.
32. In carrying out its role as grid operator Transpower presently:

- coordinates the transmission of electricity over the grid in its Grid Control Centres in Hamilton and Christchurch. This involves the balancing of electricity generation and consumption throughout New Zealand and the real-time dispatch of generators according to a price-based schedule which emerges from the New Zealand Electricity Market (NZEM); and
- decides on grid security standards and maintains security of the grid to those standards under normal, contingent and emergency conditions. Transpower coordinates the provision of equipment for the control of frequency and voltage and the procurement of suitable reserve capacity under all grid operating conditions. Although in the past Transpower has consulted with grid users, the decision making in respect of grid security has, in the end, been its own and it has enforced these decisions by requiring each party connected to the grid to enter into a Grid Operating Security Policy (GOSP) Contract.

33.

TRANSPOWER'S PRESENT ROLE IN RESPECT OF GRID SECURITY

34. At present, all elements of grid security are bundled together and are centrally determined by Transpower.

35. The Government's 20 December 1994 section 26 statement to the Commerce Commission concerning its economic policy in respect of electricity transmission states:

“Transpower should have the following specific objectives ...:

to provide an efficient, reliable and secure national grid at least practicable cost....

In these objectives:

operation of the national grid includes ensuring efficient system coordination and real time electricity security.”

36. As a result, Transpower has devised its GOSP and has entered into Grid Operator Service Contracts with the majority of its customers. These contracts are the means by which Transpower provides and charges for services of the kind listed below.

37. Examples of decisions⁴ Transpower has made unilaterally in terms of its GOSP are:

- Transpower coordinates planned outages of generating and transmission equipment for maintenance purposes and may, if the security of the grid is likely to be affected, require equipment owners to keep operating until a more suitable time;
- Transpower determines the quantity and balance of types of reserves which are available to replace generation or transmission capacity which fails, either instantaneously or over short time frames, and dispatches those reserves as required;
- Transpower specifies the technical standards and operational performance under normal, contingent or emergency conditions⁵ of equipment which it will allow to be connected to its grid;

⁴ The examples quoted are a representative selection only. There are many other components of Transpower's current grid security decision making.

- under normal grid conditions the frequency will be maintained at 50 Hertz (Hz) plus or minus 0.2 Hz;
 - following an extended contingent event the frequency will be maintained between 45 Hz and 55 Hz and efforts will be made to return the frequency to 50 Hz plus or minus 0.75 Hz within one minute;
 - following a contingent event, voltage at Transpower's substations may drop to zero or rise to 30% above nominal voltage. However, Transpower will endeavour to ensure that during such events, the voltage at Transpower's 220 kilovolt (kV) substation busbars is maintained between 242 kV and 187 kV and between 121 kV and 93.5 kV at its 110 kV substation busbars;
 - following a severe grid emergency event when there is a risk of complete or partial collapse of the grid⁶, Transpower will decide that certain consumer electrical load is to be shed, either manually or automatically; and
 - following a severe grid emergency event when there has been complete or partial collapse of the grid, Transpower will arrange and pay for sufficient auxiliary generators⁷ to allow for a black start⁸ to be achieved.
38. It is the intention of the IGSC and Transpower that, with the support of grid users, grid security issues can be resolved commercially. The IGSC's role⁹ has been:
- “To recommend a means, likely to command the *industry's support*, whereby grid security issues, that is the quality of energy transmitted on the grid, can be *resolved commercially*. This has involved identifying the elements which can be negotiated commercially and those which are inherently common to all users that therefore need to be *settled collectively*. Previously, they were bundled together and centrally determined by Transpower.”
39. Implementation of grid security decisions, will be the subject of a contract between the grid users, represented by the GSC, and the CQC.

CHANGE TO THE ELECTRICITY SECTOR

40. Regulatory change has occurred contemporaneously with the work of the IGSC in recommending how quality of supply would be set and managed, and the associated industry consultation process.
41. The Electricity Industry Reform Act 1998 (EIR Act) was enacted by Parliament on 3 July 1998. The aim of the reform is to benefit all electricity consumers by making the generation, distribution and retail sectors more efficient through the promotion of effective competition in generation and retail markets, and by curtailing the natural monopoly powers of local distribution networks.

⁵ Transpower has designed its GOSP to deal with four stages of grid stability: viz normal operation, operation following a contingent event; operation following an extended contingent event; operation following an emergency event.

⁶ That is the frequency of the grid drops below that at which generating stations may operate and most or all of such stations must shut down.

⁷ Perhaps powered by diesel fuel with alternators excited by permanently charged direct current battery banks.

⁸ The industry term for the re-livening of the grid.

⁹ 1997/98 Annual Report, Transpower New Zealand Limited.

42. The EIR Act has effected the ownership separation of electricity distribution networks and retail businesses and has also divided ECNZ into three separate generation companies. The two major types of industry participants are now companies involved in generation and retailing on the one hand, and lines businesses on the other.

THE APPLICATION OF THE COMMERCE ACT

43. In terms of section 58 a person may apply for an authorisation for arrangements to which sections 27, 28, 29, 37 or 38 may apply.
44. The applicant has argued that these sections do not apply to the Proposal and therefore that the Commission should decline to authorise the Proposal. However, the applicant has also stated that some may take the view that section 27 (in its own right and through the deeming provision of section 30), and section 29 may apply.

The Application of Section 27

45. For the Commission to grant an authorisation to a practice which may fall within the provisions of section 27, it must be satisfied that the practice in question has the purpose or effect or likely effect of lessening competition in a market, or will result in a deemed lessening of competition in a market (section 30).
46. The Commission has considered section 27 via consideration of section 30.

The Relevance of Section 30 to Section 27 Considerations

47. Section 30 has the effect of prohibiting any provision of a contract, arrangement or understanding that has the purpose or effect, or likely effect of fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to the goods or services. Such a contract, arrangement or understanding is deemed to substantially lessen competition in terms of section 27.
48. The Commission considers there are two key issues which must be considered when determining whether section 30 applies:
- (a) Do the provisions constitute a contract, arrangement or understanding between actual or potential competitors?
 - (b) If so, do they have the purpose or effect or likely effect of fixing, controlling or maintaining prices etc?

Case Law

49. The leading Australian case on s 45A of the Trade Practices Act 1974 (equivalent to section 30 of the Act) is *Radio 2UE Sydney Pty Ltd v Stereo FM Pty Ltd*.¹⁰ Radio 2UE alleged that a contract between 2MMM and 2DAY in respect of a combined rate

¹⁰ 1982 4 ATPR para 40-318 (Federal Court) and (1983) 5 ATPR para 40-367 (Full Federal Court)

card amounted to a breach of s 45A. The Court held that it did not.¹¹ At first instance Lockhart J adopted a dictionary meaning of ‘fix’ and ‘maintain’. His Honour commented on ‘fix’ at page 43,921:

“The Shorter Oxford Dictionary defines the verb ‘fix’ as: “To fasten, make firm or stable; ... to attach firmly; ... settle permanently.” The Macquarie Dictionary defines the word as: “1. To make fast, firm or stable. 2. To place definitely and more or less permanently. 3. To settle definitely, determine; to fix a price.”

50. As for ‘maintain’, his Honour noted at page 43,921:

“The verb maintain is defined by the *Shorter Oxford English Dictionary* as: “to continue, persevere in; ... continue, preserve, retain.” The *Macquarie Dictionary* defines as the word as: “1. To keep in existence or continue; Preserve; retain ... 3. To keep in a specified state, position etc.” In my view ‘maintain’ where used in section 45A, has a similar connotation to the verb ‘fix’ in that it involves some element of continuity, not merely being momentary or transitory. Generally, to maintain a price assumes that it has been fixed beforehand.”

51. His Honour also commented at page 40,318

“It is important to distinguish between arrangements (I use this expression for convenience to encompass also contracts and undertakings) which restrain price competition and arrangements which merely incidentally affect it or have some connection with it. Not every arrangement between competitors which has some possible impact on price is per se unlawful under the section.”

52. On appeal the Full Federal Court at page 44,401 observed:

“In our view the word ‘fixing’ in section 45A takes colour from its general context and from the words used with it – ‘controlling or maintaining’ - and not every determination of a price, following discussion between competitors, will amount to a price ‘fixing’ - There must, we believe, be an element of intention or likelihood to affect price competition before price ‘fixing’ can be established. This will often be a matter of inference, requiring no direct evidence for it to be established.”

53. No Australian or New Zealand court has considered the meaning of ‘control’ in a price fixing context.

54. *Radio 2UE* holds that where a price is determined following discussion between competitors, price fixing can be inferred where there is an element of intention or likelihood to affect price.

55. The Commission considered section 30 in *Insurance Council of New Zealand (Inc)* Decision 236 (1989) 2 NZBLC (Com) para 99-522. There the Commission adopted Lockhart J’s meaning of ‘fix’ and ‘maintain’. The Commission said of ‘control’ at page 104,482:

“The word ‘control’ was considered in the case *TPC v Ansett Transport Industries (Operations) Pty Limited* (1978) ATPR para 40-071. Although considered in the context of a

¹¹ Two Sydney commercial FM radio stations, 2MMM and 2DAY, produced a combined Sydney FM rate card for advertisers on their two stations. The combined card was intended to draw the attention of advertisers to the potential advantage of advertising on the stations as their market shares had increased considerably since they had first gone to air. The rates appearing on the combined card were the sum of the individual rates offered by each station for a spot of the relevant category appearing in its individual rate card. Each station fixed and charged its own rates independently of the other. 2MMM’s rates were higher than those of 2DAY. Neither station consulted the other in compiling or changing its card and the rates on the individual cards were not always the rates actually charged to clients because bargaining took place and benefits given to clients included discounted rates. The combined card did nothing to reduce either station’s flexibility to change its advertising rates whenever it wished to do so and 2MMM had done so.

take-over/merger case the definition provided could have relevance to price movements. The meaning adopted was “to exercise restraint or direction upon the free action of; to hold sway over, exercise power or authority over, to dominate or command.”

56. The Commission summarised the phrase ‘fix, control or maintain’ at page 104,482 as follows:

“In all of the cases noted above, the terms ‘fix’, ‘control’ and ‘maintain’ are synonymous with an inference with the setting of a price, as opposed to allowing such price to be set in response to changes in the supply and demand for goods and services. Thus, in a technical sense any agreement by competitors in a market which has an influence on, or interferes with the setting of a price, amounts to ‘price fixing.’ However, following Lockhart J for that interference to have any significance in a competition sense, the price that is fixed must not be “instantaneous or merely ephemeral, momentary or transitory or be the result of arrangements which merely incidentally affect it.”

57. The Commission concluded at page 104,483 that section 30 only applies to price fixing *in a competition sense* and that it is not sufficient for the provision under consideration merely to influence price. The Commission decided that the agreement in question did not contravene section 30. The Commission observed at page 104,483:

“Thus while the Agreement might have influenced the price of insurance, the Council having itself stated that the price of insurance sold by a signatory is different to what it would have been in the absence of the Agreement, the Commission is not satisfied that this amounts to ‘price fixing’ in a competition sense. The effect of the Agreement is to remove the cost element from the price, the price minus that element then moves in response to normal competitive pressures. Accordingly, the Commission considers that the agreement does not constitute the ‘fixing’, ‘controlling’ or ‘maintaining’ of the price of motor vehicle insurance in terms of section 30 and cannot therefore be deemed to ‘substantially lessen competition’ in terms of section 27.”

58. In Decision 236 the Commission concluded that the agreement did not restrict buyers’ choice, as, once the cost element had been removed, the price for motor vehicle insurance moved in accordance with “normal competitive pressures”.

Arrangement Between Competitors

59. In written submissions and at the conference, Transpower contended that the arrangements do not fall within section 30 of the Act, but with the rider that if section 30 did apply, the Proposal was exempted by section 33. In part its contention was based on the view that the parties to the Proposal are not in competition with each other in relation to the common elements of quality, because only one standard can be set for those elements at one time. It accepted, however, that parties to the Proposal are in competition with each other as suppliers and acquirers of electricity traded across the grid.
60. The Commission agrees with Transpower that “common elements of quality” cannot themselves be supplied or acquired independently of electricity. However, having had regard to the submissions made to it, the Commission considers that it is electricity which is relevant to the issue of section 30. The Commission agrees that parties to the Proposal are in competition with each other in respect of supplying and acquiring electricity.

Purpose or Effect of Fixing, Controlling or Maintaining Prices

61. Transpower submitted that the Proposal does not have the purpose of fixing, controlling or maintaining prices. The Commission accepts that the purpose of the Proposal is to set common elements of quality.
62. Transpower has argued that the price of electricity traded across the grid is not fixed by the Proposal but derives from transactions with the NZEM, bilateral contracts or transactions between the retail and generating arms of vertically integrated firms. Transpower has also argued that the cost of maintaining common quality is unlikely to have a permanent or ubiquitous effect on the price of electricity and is very small (\$26-30 million) as a proportion of total energy traded through NZEM (\$1.5 billion). Transpower submitted that the Proposal at most merely incidentally affects the price of electricity traded across the grid, and as such it does not constitute price fixing for the purpose of section 30.
63. The Commission does not accept these arguments. Decisions which will be made in this regard will have an impact on the cost of common quality. These costs will be passed on to grid users in a way which will directly impact on the price of electricity. In the words of the Full Federal Court in *Radio 2UE*, the decisions are “(likely) to affect price competition”. Further, the Commission considers that given the ubiquitous and permanent effect of common quality standards, and the absolute level of costs involved, the Proposal cannot be viewed as merely incidentally affecting the price of electricity.
64. In the Commission’s view, therefore, the Proposal is likely to have a continuing and permanent effect on the price of electricity and therefore, by the application of section 30 of the Act, is deemed by section 27 to have or to be likely to have the effect of substantially lessening competition in a market.

Comparison with other cases

- Insurance Council - Decision 236
65. The Commission considers that as the facts here are materially different, its Decision 236 does not assist Transpower. In Decision 236, the Commission decided the insurance companies’ agreement to adopt a “knock for knock” agreement did not restrict buyers’ choice, as once the cost element of establishing individual liability had been removed, the price for motor vehicle insurance moved in accordance with “normal competitive pressures”. The Commission was able to conclude in the circumstances of that case that the arrangement merely incidentally affected the price of motor vehicle insurance.
 66. Given the ubiquitous and permanent effect of the Proposal, the Commission concludes that the price for electricity bought and sold across the grid will not move fully in accordance with normal competitive pressures. While the methodology for allocating the costs of maintaining particular levels of the common elements of quality has not yet been identified, the outcome of the adoption of a methodology is clear. It will impact on price and the effect will be more than incidental.

- Wholesale Electricity Market Rules - Decision 280
67. In Decision 280, an application for authorisation of certain pricing mechanisms proposed for the New Zealand Electricity Market, the Commission determined that it lacked jurisdiction. In that decision, the Commission found there was no element of certainty, continuity or permanence as to price resulting from the proposed price mechanism. Transpower argues the Commission should reach a similar conclusion in this case. However, the Commission considers the facts in Decision 280 are materially different. In the present case, the Commission considers the Proposal is likely to have a continuing and permanent effect on the price of electricity and therefore, by the application of section 30 of the Act, is deemed by section 27 to have or to be likely to have the effect of substantially lessening competition in a market.
- Number Administration Deed – Decision 356
68. Transpower has suggested that, on the question of the application of section 30, there is an analogy between the current case and the recent decision made on an application by various telecommunication companies for authorisation of the proposed Number Administration Deed (Decision 356 of 17 May 1999).
 69. Mr David (for Transpower) stated at the conference:

“The arrangements in the Number Administration Deed are very similar to the arrangements under the MACQS. The Number Administration Deed provides for an industry based management committee with an independent chair to develop, within certain parameters, processes for administering numbering resources in an efficient manner and to decide the most appropriate form of number portability. There are many similar aspects to the Number Administration Deed and the MACQS. Importantly, however, both the Number Administration Deed and Transpower’s proposed arrangements contain the means by which the cost for the arrangements will be recovered by the parties.

The Number Administration Deed provides that each party to the Deed must pay a fixed fee, with the remainder being apportioned to each party according to the party’s share of the number of allocations made each year. In addition it provides for the allocation of costs implementing the preferred number portability option which is to be determined in due course.
 70. Section 30 was not seen to apply to the Number Administration Deed. Transpower submits that section 30 equally should not apply to the arrangements for which authorisation has been sought.”
 71. The Commission accepts Mr David’s summary of the Number Administration Deed case. However it does not accept that the case is fully analogous to the current case.
 72. The matters which were central to the Number Administration Deed case, number administration and future number portability solutions, are facilities which will be available equally to all parties to the Deed. Their presence will enhance the competitive state of telecommunication markets. Parties to the Deed are not currently competing in the purchase or supply of these facilities. Nor will they be when the Deed is put into effect. Each party will have access to the facilities. Further the cost of access to these facilities will not necessarily impact on the price consumers pay for basic telecommunication services.
 73. In contrast, the decisions relating to the quality of electricity, and the way costs incurred in achieving that quality are allocated, will necessarily impact directly on the

price of electricity. Further, those who are generating or acquiring electricity, of whatever common level of quality, are currently competing against each other for the purchase or sale of that electricity, and will do so in the future.

74. An essential element for any arrangement to fall within the price fixing provisions of section 30 is that the goods or services for which the prices are fixed, controlled or maintained are acquired or supplied by the parties to the arrangement in competition with each other. That essential element was not there in the Number Administration Deed case. It is there in the current case.
75. The Commission therefore concludes that the Number Administration Deed case does not provide a relevant precedent for determining whether or not section 30 applies to the current Proposal.

Exemptions Via Section 33

76. Section 33 exempts a provision of a contract, arrangement, or understanding from section 30 where it relates to the price of goods or services to be collectively acquired.
77. The applicant has argued that even if the Proposal fall within section 30, they are exempted by the provisions of section 33 as a joint buying arrangement. However the Commission considers section 33 does not apply in this case. In the Commission's view, the parties to the Proposal will not act collectively in acquiring the common elements of quality. They may act in parallel, nevertheless each will be acquiring the common elements of quality in an individual transaction.
78. The Commission concludes that section 33 does not exempt the Proposal from section 30.

The Application of Section 29

79. Sections 29(3) and 29(4) prohibit any person entering into a contract, or arrangement, or arriving at an understanding, that contains an exclusionary provision, or giving effect to an exclusionary provision. Section 29(1) defines an exclusionary provision as follows:

“For the purposes of this Act, a provision of a contract, arrangement, or understanding is an exclusionary provision if—

- (a) It is a provision of a contract or arrangement entered into, or understanding arrived at, between persons of whom any 2 or more are in competition with each other; and
- (b) It has the purpose of preventing, restricting, or limiting the supply of goods or services to, or the acquisition of goods or services from, any particular person, or class of persons, either generally or in particular circumstances or on particular conditions, by all or any of the parties to the contract, arrangement, or understanding, or if a party is a body corporate, by a body corporate that is interconnected with that party; and
- (c) The particular person or the class of persons to which the provision relates is in competition with one or more of the parties to the contract, arrangement or understanding in relation to the supply or acquisition of those goods or services.”

80. The applicant has stated:

“Under section 29(1)(b) the arrangements could be said to have the purpose of preventing the supply of system co-ordination services to a class of persons, being persons who are not willing to pay for system co-ordination services necessary to maintain a defined level of quality, or to meet the required level of quality, or to meet the required technical standards (if any), and such system co-ordination services are provided by a party to the arrangement (ie. the CQC).”

81. MEUG said in its submission;

“Any party seeking to have generation dispatched or load supplied who is not prepared to abide by the rules for setting common quality standards set with the governance arrangements in the Proposal will be excluded from selling or buying power across the grid.... The effect is exclusionary, and the purpose is also. It is the ability to exclude those not prepared to abide by the rules that gives the arrangements the leverage to make them mandatory. Therefore we believe these arrangements are designed to exclude those who will not abide by the rules and must fall within the provisions of section 29.”

82. The Commission does not consider that the Proposal has an exclusionary purpose. It considers that it is much more likely that it is being entered into to meet the guiding principles. It considers that the obligations placed on the parties connected to the grid to comply with the provisions of the Proposal is not evidence of exclusionary purpose.

83. Further the Proposal does not specify any particular penalty for failure to comply with the provisions of the Proposal. The penalties may include possible exclusion from access to the grid. If there is evidence that unreasonable penalties were being imposed which lessened competition in a market, the parties concerned are likely to be subject to action under Part II of the Commerce Act.

84. As there is no exclusionary purpose, the Commission concludes that section 29 of the Act does not apply to the Proposal.

THE COUNTERFACTUAL

85. When carrying out an assessment of an application under section 58 of the Act, the Commission must assess the likely competitive effects of the Proposal, and any public benefits or detriments likely to result. This requires the Commission to determine a benchmark against which to measure the likely competitive effects and public benefits. As the Commission has noted in previous decisions, the benchmark is the counterfactual; that is, the situation that would be likely to exist in the absence of the proposed arrangement. Thus it is a with and without comparison rather than a before and after comparison.

86. The counterfactual is not necessarily the arrangement which might be preferred by the Commission or by others with an interest in the sector. The Commission does not have the mandate or the expertise to be a market designer. The counterfactual is simply the Commission’s pragmatic assessment of what is likely to occur in the absence of the proposed arrangement.

87. Transpower argued that the counterfactual would not involve collective arrangements. Rather it has suggested that the “most likely, and perhaps only, approach available to Transpower would be to attempt to maintain system integrity using existing

arrangements. Transpower's economic adviser, Law & Economics Consulting Group (LECG), noted in the application:

“Should the proposed arrangements not proceed, the most likely alternative is that Transpower will become increasingly inflexible with respect to enforcement of the existing arrangements as it struggles to cope with a multiplicity of interests and behaviours of the many new entities using the grid and therefore retreats inside an explicit set of rules. Transpower might increase consultation with grid users on an individual basis, but the growing number of grid users and their divergent interests will make this process increasingly costly and unproductive. The central point for this analysis is that Transpower unilaterally would remain responsible for deciding the level of common elements of quality, determining how that policy would be achieved, and purchasing or providing the services necessary to achieve secure and reliable electricity supply in real time.”

88. These points were also made at the conference by Mr Lusk, Transpower's General Manager of Industry Development.
89. MEUG suggested that the Transpower counterfactual, and that adopted by the Commission in its draft determination (which was similar), would be contrary to Transpower's Statement of Corporate Intent (SCI). In its view, to meet the SCI there would need to be a change away from Transpower making decisions on a unilateral basis, although it considered that it would take time for other arrangements to develop.
90. Todd stated that arrangements which allowed Transpower to make decisions on common quality without the input of grid users would not meet the Ministers' guiding principles set out in the 4 September 1997 statement, and therefore should not be accepted as a counterfactual. The ENA suggested that in the absence of the proposal, there would be a reasonably rapid evolution to arrangements which had a greater level of acceptance to all parties in the industry. WEL Energy Group Ltd (WEL) said that it believed that without the proposal, industry participants would have to act jointly to reach decisions on grid security issues over time.
91. In its Draft Determination, the Commission said that it did not believe that any single alternative arrangement to the Proposal would have the necessary support of relevant parties to allow it to be readily implemented. The Commission continues to believe that would be the case. The Proposal has been drawn up only after extensive and apparently difficult negotiating sessions involving concessions and trade-offs by all parties. While the Proposal does not have unanimous support, the IGSC has achieved a level of consensus. A similar level of consensus would be needed before an alternative could be put in place.
92. The Commission accepts the view put forward by a number of parties that there is strong pressure for a change from the status quo. In the first instance, this comes from grid users. All accepted the proposition that it is desirable for those who are affected by the level of quality of electricity to make decisions on quality. These parties will no doubt continue to push to have a say on issues relating to common quality.
93. In addition pressure for change from the status quo will continue to come from the Government. The Government's position has been clearly set out in the guiding principles which include:

“Grid users should be responsible for selecting the quality and quantity of services which they are willing to pay.”

94. The guiding principles are reflected in Transpower's SCI. As the application notes, under its SCI, Transpower should strive to:
- make services contestable wherever possible
 - make services available at a quality and quantity agreed by customers and produce them at least cost
 - allow customers to make trade-offs between price and service level
 - enable an appropriate majority of customers to make the trade-off where the services are in common.
95. The SCI sets out the overall intentions and objectives for the Board of Transpower.
96. The Commission accepts that these pressures from grid users and from Transpower's owners for a change in the present means of determining grid security will continue if the Proposal does not proceed. These pressures are likely to push the relevant parties to reach consensus on alternative arrangements which meet the guiding principles.
97. The Commission is not in a position to specify with any certainty how details of the alternative arrangements may vary from the Proposal which is the subject of the application. To meet the guiding principles, it is likely they will involve collective decision making, although voting rights may vary from those in the Proposal in a way which it is not possible to determine at this stage. The group that appeared to feel strongest that it should have additional voting rights, distributors, will not necessarily be in a stronger position in the alternative proposal. However, under the Proposal distributors are able to exert a significant influence through their membership of GSC and, perhaps more importantly, from their ability to veto change by refusing to sign new contracts with the CQC.
98. Another matter raised by some interested parties in submissions and at the conference was the provision in the Proposal that Transpower must give its agreement before the CQC role is made contestable. Mr Lusk of Transpower suggested at the conference that there was a risk involved in splitting the system owner and system operator functions and that it was therefore appropriate that Transpower assess the risk before the CQC role was offered to others. Mr Bradley of M-co suggested that the members of the IGSC who agreed to the provision were swayed by Transpower's SCI (which requires it to make services contestable wherever possible). Mr Currie of MEUG said that his organisation did not view the provision as being either an insurmountable or material problem. Mr David for Transpower pointed out that Transpower would not have an unfettered veto on the question of the contestability of the CQC function as it would be subject to the provisions of section 36 of the Commerce Act in respect of any action it took in respect of the provision.
99. In summary, the Commission considers that the appropriate counterfactual is one in which the relevant parties will strive to obtain a consensus on an alternative arrangement for collectively determining elements of common quality. In time, a reasonable consensus will be reached. It is likely that the alternative arrangement will contain many features of the Proposal which is the subject of the application, but will address some of the concerns expressed about the Proposal. However the Commission

believes that it is likely that the alternative arrangement will contain similar veto powers for Transpower, and that it is likely that voting and other rights given to distributors will not be materially different from those in the Proposal.

100. From the Commission’s perspective, the significant difference between the Proposal and the counterfactual is the time of their introduction. The counterfactual would require additional rounds of designing, consultation and consensus seeking. Because of the collective decision making arrangements in the counterfactual, it too would require Commission authorisation. The Commission believes that it may take significantly longer to implement the counterfactual than to implement the Proposal. During that period, the status quo is likely to continue.

MARKET DEFINITION

101. Analysis of a trade practice in terms of the Act requires that the activities affected by the practice in question are placed within market boundaries which most clearly highlight the competitive implications of the practice.
102. The Commerce Act defines the term “market” as being a market in New Zealand for goods and services as well as for other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
103. Market definition principles have been set out by the High Court in *Telecom Corporation of NZ Ltd v Commerce Commission* (the AMPS A case):¹²

“First, and most generally, we seek to identify the area or areas of close competition of relevance for the application(s). In other words, we seek to identify the constraints upon the price and production policies of firms whose conduct is of relevance for the matters litigated. In this matter it is of especial importance to highlight the constraints upon Telecom’s price and production policies.

Secondly, competition may proceed both through substitution in demand and substitution in supply in response to changing prices or, more comprehensively, the changing price-product-service packages offered The mental test that prompts a summary evaluation of the evidence is to ask how buyers and sellers would likely react to a notional small percentage increase in price of the products of interest (the ‘price elevation test’). . . .

Thirdly, the market is a multi-dimensional concept – with dimensions of product, space, functional level, and time. Here we need to give special attention to the principles that should govern the isolation of the dimensions of function and time.

If we ask what functional divisions are appropriate in any market definition exercise the answer, plainly enough, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers.”

104. In respect of the product dimension of market definition, the Commission considers that the relevant product is electricity. While other energy forms can be substituted for electricity on occasions, they are not considered to be a sufficiently close substitutes to justify placing these other energy forms in the same product market as electricity.

¹² (1991) 4 TCLR 473, 502; 3 NZBLC 102,340, 102,362.

105. The matters of relevance to the application impact on the electricity sector throughout the country. The Commission considers that it can properly assess the application using markets which are national in scope.
106. The applicant, and its adviser, LECG, have suggested that the relevant functional markets are those for the generation of electricity, the transmission and distribution of electricity, the retail supply of electricity, the co-ordination of electricity supply (grid operations), the provision of ancillary services including instantaneous reserve, voltage support, frequency keeping services, and black start facilities, and the service market for market trading.
107. The Commission accepts that these markets are appropriate for the consideration of the application. No interested party suggested otherwise.

THE COMPETITIVE IMPACT

Introduction

108. In undertaking the assessment of the competitive impact of the Proposal, it is necessary to bear in mind the limited scope of the authorisation application. As stated in paragraph 56 of the application:

“The applicant seeks authorisation of the arrangement ... prescribing *how* individual decisions relating to the common elements of quality will be made under MACQS. The applicant does not seek authorisation for any of the *individual decisions* which themselves will continue to be subject to the provisions of sections 27 and 29 of the Commerce Act (unless themselves authorised following further application in the particular case).”

Aspects of the Proposal and Comparisons with the Counterfactual

Coming together to adopt decision making procedures

109. The Proposal includes arrangements whereby users of the grid, some of whom will be competitors, come together to make decisions which, among other things, impact on the price of electricity bought and sold across the grid.
110. The counterfactual includes similar arrangements, although these arrangements will take longer to implement. In the short term, under the counterfactual, Transpower will make decisions on common quality in much the same way as it does at present.

The adoption of voting procedures.

111. The Proposal includes a mechanism for making decisions on matters relating to common quality whereby decision rights in the first instance are allocated to generators and ultimate consumers of electricity in proportion to the quantity of electricity they inject into the grid, or consume. These decision rights are freely transferable. If no assignment of these decision rights is made by the generator or end user, then the member of the Metering & Reconciliation Information Agreement (MARIA) or NZEM,

which is responsible for the reconciliation of their information will obtain the decision rights.

112. Four persons will be elected to the GSC by those with decision rights (three by generators and one by retailers). The GSC will also comprise six nominated persons, one of whom will represent grid owners, one distribution businesses, one small end consumers, one major industrial users, one commercial users, and an independent Chair. The GSC will report on and make decisions on matters affecting common quality. However those with voting rights holding 5% of eligible votes may call for a vote on any new proposal and a majority of 75% of votes cast would be required for a change to be implemented.
113. In the counterfactual the Commission anticipates that similar provisions will apply. Voting rights, and rights to membership of GSC may differ, but in a way which still allows grid users and interested parties an effective influence on the way elements of common quality are determined. Until the alternative arrangements can be designed and implemented, these parties will have no more influence than at present.

Determining the level of common quality and the methodology to be used to allocate the associated costs

114. The decision making arrangements in the Proposal involve the GSC, and also generators and ultimate consumers (or those to whom they have assigned their decision rights).
115. In the counterfactual similar provisions will apply although there will be a delay before they are implemented. In the short term the status quo will apply.

Implementing changes in common quality standards

116. Changes in common quality will require a range of new bilateral contracts to be entered into. They will require the CQC to contract with generators, with grid asset owners, with distributors and with directly connected loads. Failure to obtain the agreement of any of these parties may make it impossible to implement the change. In addition, changes require the consent of CQC.
117. Similar provisions are likely in the counterfactual.

The Appointment of a CQC and the obligations placed on the CQC

118. The application notes that the initial CQC is to be Transpower. The GSC and Transpower are required by 31 December 2002 to review the CQC arrangements to determine whether it is feasible for a person other than Transpower to perform the CQC role. If they both agree that it is feasible, then they will develop and implement a process for making the role contestable. The Commission considers that effectively this gives Transpower the ability to veto the appointment of any other party to be the CQC in its place. Any decisions made on the feasibility of the CQC role being made contestable will not be protected by any authorisation the Commission may give to the Proposal.

119. The Commission considers that similar provisions are likely in the counterfactual.

The Provision in Proposed Security Contracts that Place Common Obligations on Grid Users

120. The Proposal requires the CQC to place common obligations on grid users.

121. Similar provisions are likely in the counterfactual.

The Impact in Individual Markets

The Generation/Wholesale Market

122. Principal players in the generation market include Central Electric, Contact, King Country Energy, Todd, TransAlta, Trustpower and the three SOEs formed from ECNZ: Mighty River Power, Genesis Power, and Meridian Energy.

123. The Commission considers that the guiding principles, and the membership of the GSC make it unlikely that the GSC will make decisions which raise entry barriers or to otherwise reduce competition in this market. However if it did, any such decisions would be subject to the Commerce Act. The Commission's authorisation of the Proposal would not protect the parties concerned from enforcement action under the Act in these cases.

124. In its submission Todd provided a number of examples where it considered that the Proposal would be likely to lessen competition in the generation/wholesale market. The Commission has given careful consideration to these examples, but does not consider that they demonstrate that the proposal would lessen competition in this market. Many of the examples given related to Transpower's market power in the transmission market and were unrelated to common quality matters. Others could be relevant to a competition analysis of the Proposal only if the counterfactual chosen differs from that adopted by the Commission.

125. No other party argued that the Proposal would lessen competition in the generation/wholesale market.

The Transmission Market

126. Transpower, as the supplier of transmission services, is considered to be in a dominant position in the market. The Proposal will not affect that situation, nor will it reduce the constraints on Transpower in this market. Rather, by separating elements of grid security and other aspects of grid operations from the management of the grid assets, and making those functions more transparent, it may increase the constraint on Transpower.

127. The Commission considers that there would be no lessening of competition in the transmission market as a result of the Proposal.

The Distribution Markets

128. The distribution markets comprise a series of discrete markets, the boundaries of each corresponding with the boundaries of individual networks. The owner of each network is considered to be in a dominant position.
129. Distributors are required to meet various obligations to maintain the chosen common elements of quality. Under the Proposal, distributors will be represented on the GSC and will therefore have a greater influence on these elements and related obligations than they have at present. It is envisaged that the influence distributors would have in the counterfactual would match that arising from the Proposal.
130. Distributors expressed their concern to the Commission about the likelihood that much of the cost of common quality will be charged to them. That is the present situation. It may be the situation possible under the Proposal. It may be the situation under the counterfactual. How the costs of common quality are allocated will be a matter for the GSC to decide, and will not be protected by the Commission authorising the Proposal. If the GSC allocates costs in a way which lessens competition in a market, remedial action can be taken under the Commerce Act.
131. The Commission considers that competition in the distribution markets would not be lessened by the Proposal.

The Retail Market

132. The electricity retail market has changed substantially with the requirement under the EIR Act that distribution and retailing be separated. Generators now have substantial interests in this market. The requirement that deemed profiling be introduced appears likely to make the supply of electricity to consumers more contestable than at present.
133. The Commission received no submissions which suggested that the Proposal would lessen competition in the retail market. Nor does the Commission believe that any lessening of competition will occur.

The Ancillary Services Market

134. Ancillary services comprise in the main interruptible load and spinning reserve, frequency keeping and voltage support. At present these services are acquired by Transpower. It is proposed that in future the CQC will be the buyer of the services under the direction of GSC. The applicant has argued that the Proposal will make the criteria for purchasing ancillary services more transparent and will therefore create more opportunities for providers of ancillary services to compete.
135. The Commission considers that, in the counterfactual, the CQC will acquire ancillary services in the same way as in the Proposal.
136. The Commission received no information which suggested that the Proposal would lessen competition in the ancillary services market.

The Grid Operations Market

137. This market encompasses the functions proposed to be undertaken by the CQC. The nature of the tasks performed by the grid operator (co-ordination of resources, scheduling, dispatch, purchasing of ancillary services) means that they must be undertaken by a single entity. Accordingly, the grid operator will not face competition in its day to day operations.
138. However, the grid operation function is potentially contestable. For instance, in Alberta the task of grid operator was transferred from the transmission asset to an Irish company.
139. While the application notes that Transpower will be the CQC, the Proposal does not lock in this arrangement. MACQS at chapter 7 clause 5.2 states:

“5.2 Review of CQC arrangements

It is acknowledged that the contestability of functions where that is possible can bring benefits to the New Zealand economy as a whole. It is further acknowledged that the members and Transpower New Zealand Limited do not, as at 31 March 1999, know whether it is practical or desirable for the CQC role to be made contestable. By 31 December 2002, the GSC and Transpower New Zealand Limited will together conduct and complete a review which will consider:

The nature of CQC’s role; and

Whether it is feasible that the role can be performed by a person other than Transpower New Zealand Limited. If, following this review, the GSC and Transpower New Zealand Limited agree that the CQC role should be made contestable, then the GSC and Transpower New Zealand Limited will develop and implement a process for making the role contestable including making a joint proposal for any necessary changes to the contract.”

140. The Proposal requires however that *both* GSC and Transpower must agree before the CQC role is made contestable. Thus Transpower has the ability to veto such a move. Transpower has told the Commission that it is necessary to have this provision as Transpower has a statutory obligation to ensure grid security and it therefore must satisfy itself that a change in the CQC would not put this at risk before it could agree to allow others to perform this task. It has stated that it would not unreasonably veto any moves to make the CQC function contestable because, inter alia, it is obliged under its SCI to make services contestable wherever possible. Further, it has suggested that any move unreasonably to prevent the function from becoming contestable could put it at risk under the Commerce Act.
141. The Commission recognises that Transpower has a particular obligation to ensure that the grid remains secure, and in these circumstances its veto power may not be unreasonable. Further the Commission notes that Transpower’s shareholder, the Government, has stated that services should be contestable wherever possible. Nevertheless under the Proposal there is the potential for Transpower to maintain control of the CQC role when it is desirable that it become contestable.
142. Of relevance to the current application however is the comparison with the counterfactual. In the counterfactual the Transpower veto power is likely to be the same as in the Proposal. Thus in comparison with the counterfactual, the provisions in

the Proposal relating to the contestability of the CQC functions do not lessen contestability and, therefore, competition in the grid operations market.

Summary of Competitive Impacts

143. In assessing the competitive impacts, the Commission has recognised that the application is limited in scope. The applicant does not seek authorisation of the particular form of the contracts that embody the arrangements discussed. Specific decisions by the GSC, by the CQC and by the parties to MACQS would not be protected from action under the Commerce Act by any authorisation the Commission may give to the current proposal.
144. The Commission is of the view that the Proposal will not result in a loss of competition. It notes that the Proposal varies from that which was the subject of the application late last year by, amongst other things, providing for representation on the GSC by consumer groups (as well as by generators, retailers and distributors). Also decision rights have been given to the ultimate consumer of electricity (as well as to the generator). These changes appear to have met many of the concerns expressed last time about the potential for quality levels being determined, or costs being allocated, in a way which reflects the interests of those with decision rights at the expense of those without.
145. A number of distributors have expressed concerns about the potential for costs being inappropriately placed on distributors because of the way decision rights will be allocated. However decisions on how costs are allocated are not the subject of the Proposal before the Commission.
146. The Commission is of the view that (absent section 30 of the Act) the Proposal would not lead to a lessening of competition in the generation, distribution, retailing, ancillary services, and grid operations markets.

ASSESSING BENEFIT TO THE PUBLIC

147. Having concluded that the Proposal falls within the ambit of section 27 (via section 30) of the Act, the Commission is required to make a determination in terms of section 61(6).
148. Section 61(6) of the Act states:

“The Commission shall not make a determination granting an authorisation pursuant to an application under section 58(1) to(4) of this Act unless it is satisfied that –

- (a) The entering into of the contract or arrangement or the arriving at the understanding; or
- (b) The giving effect to the provision of the contract, arrangement, or understanding; or
- (c) The giving effect to the provision of the contract, arrangement, or understanding; or
- (d) The carrying out or enforcing of the terms of the covenant –

as the case may be, to which the application relates, will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition that would result, or would be likely to result, or is deemed to result therefrom.”

149. Section 3A of the Act is relevant to the assessment of whether the Deed results in a benefit to the public which would outweigh the lessening in competition. It states:

“Where the Commission is required under this Act to determine whether or not, or the extent to which, the conduct will be likely to result, in a benefit to the public, the Commission shall have regard to any efficiencies that the Commission considers will result, or will be likely to result from that conduct.”

150. The Commission’s Public Benefit Guidelines¹³ provides the framework used for assessing the public benefit, and the detriment arising from the lessening in competition.

Detriments

151. In general, the detriments which the Commission takes into account in its analysis fall within the headings of loss of allocative efficiency, loss of productive efficiency and loss of dynamic efficiencies. Without a loss of competition, such detriments do not arise.
152. As described above, the Commission has concluded that the Proposal does not have the effect of lessening competition in a market. Accordingly it has attributed no competitive detriment to the Proposal.

Public Benefits

153. In the Guidelines, the Commission states that it encourages applicants to quantify projected efficiency gains as far as possible. This has been supported by the Courts. For instance in the AMPS A case,¹⁴ Richardson J, sitting as one of the five judges in the Court of Appeal, remarked on the:

“... responsibility on a regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgement to justify a conclusion that detriments in fact exceed quantified benefits.”

154. In this case no party attempted to quantify public benefits with any precision. The Commission accepts that such a task would be very difficult in this case. In view of the absence of detriments, precision is not necessary.

155. LECG (for Transpower) has stated:

“Besides the competitive effects, the proposed arrangements are likely to result in a net public benefit. Benefits will come from greater collection and flow of information under the proposed arrangements, leading to decisions that are more likely to reflect the collective preference of the

¹³ Guidelines to the Analysis of Public Benefits and Detriments in the Context of the Commerce Act, Commerce Commission, October 1994

¹⁴ *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3NZLR

grid users. The proposed arrangements would lead to better specification, monitoring and enforcement of standards relative to the counterfactual, reducing the likelihood of system failures. In addition, there will be public benefits through lower costs from determining the common elements of quality for which there is a net gain from specifying a standard, and from allowing the grid users to bargain over various levels of quality. There will also be benefits from innovation that leads to a reduction in the set of common elements and different ways to achieve the standard of quality. Therefore, overall the proposed arrangements are likely to result in substantial public benefits.”

156. These claimed benefits fall within two principal categories – lower transaction costs and improved security of supply. They are considered under separate headings below.

Lower transaction costs

157. The Commission accepts the general proposition that those who pay for quality and those who bear the cost of inappropriate levels of quality are best placed to make decisions on the appropriate quality levels. It agrees that by giving decision rights in the first instance to generators and the ultimate consumers of electricity, the Proposal is likely to enhance the quality of decisions. The Commission notes that consumer representatives will have a significant representation on the GSC, which has a critical role in determining quality levels.
158. Further the Commission considers that as decision making is devolved to those parties who bear the costs and receive the benefits of different levels of quality, they are more likely to focus resources on those elements for which the benefits of improved specification outweigh the costs, and this is likely to lead to a better allocation of resources.
159. The Commission accepts that the Proposal, by bringing grid users together to determine common aspects of quality, will be more likely than the status quo to make sensitive information available to the decision-making process. It is also likely to assist the resolution of disputes between the affected parties.
160. While the Proposal is likely to lower transaction costs significantly compared with the status quo, what is relevant is the comparison with the counterfactual. The counterfactual will have many features in common with the Proposal. Ultimately it may have the same beneficial impact on transaction costs as does the Proposal. However in comparison with the Proposal, there may be a significant delay in implementing the changes.
161. The Commission accepts that the earlier reduction in transaction costs from the Proposal is a relevant public benefit.

Improved security of supply

162. As discussed above, the Commission accepts that the Proposal will improve the quality of decision making. This is largely because decision makers will have access to better information than at present, and will also have enhanced incentives to make the correct decisions. Further it considers that those connected to the grid will be more likely to comply with technical and performance standards than at present. In part this is

because of the likely improvement in monitoring standards, and in part it is because they will have been involved in the standard setting process.

163. The Commission considers that this is likely to reduce the possibility of system failure. As LECG has pointed out, the cost of a total system collapse is very large. It has suggested that based on the evidence of the New York collapse on 13 July 1977, a collapse of that magnitude in New Zealand may be in the order of \$2.3 billion dollars. The Commission has not verified that figure, but accepts that it would be very large. Even a small reduction in the likelihood of a system collapse is a public benefit.
164. As discussed when considering benefits arising from lower transaction costs, what is relevant is the comparison with the counterfactual. The counterfactual is likely to achieve much the same improvements in security of supply, but from a later date. The earlier introduction of the improvements in security is considered to be a relevant public benefit.

Conclusion on Benefit to the Public

165. Public benefits have been described rather than quantified. Nevertheless the Commission considers that they are real. They arise principally from arrangements which lower transaction costs and improve security of supply being put in place earlier than would otherwise be the case.
166. The Commission must be satisfied that the benefit to the public from the Proposal outweighs the detriment from the lessening in competition before it can grant an authorisation.
167. In this instance, the Commission has concluded that there is no detriment from the Proposal, while public benefits would ensue.
168. The Commission therefore concludes that the Proposal will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result, or would be likely to result or is deemed to result therefrom.

OVERALL CONCLUSION

169. The Commission has considered whether the Proposal should receive authorisation under sections 58(1) and 58(2) of the Act. The Commission finds that the Proposal will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result, or would be likely to result or is deemed to result therefrom. It concludes that the Proposal should be authorised in terms of section 61(6) of the Act.
170. The Commission has also considered whether the Proposal should receive authorisation under sections 58(5) and 58(6) of the Act. The Commission declines to exercise its power to grant an authorisation in terms of section 61(7) of the Act on the basis that the entering into, or giving effect to the Proposal does not amount to the entering into, or giving effect to an exclusionary provision in terms of section 29 of the Act.

DETERMINATION

171. Pursuant to sections 58 and 61(1)(a) of the Commerce Act 1986, the Commission determines to grant an authorisation to:

An arrangement (currently in the format of the MACQS) under which rights are initially allocated to parties based on their past or, in some cases, prospective generation or consumption of electricity (although a generator's or consumer's generation or consumption can be allocated to another person for the purpose of the arrangement) to do all or any of the following (either through a committee or by passing a resolution with a required majority of up to 75% of votes cast):

- decide the common elements of quality;
- appoint a CQC to provide or acquire services necessary to maintain the common elements of quality;
- decide performance objectives for the CQC;
- decide technical and performance standards (where technical and performance matters affect the common elements of quality) for entities forming or connecting to the national grid or whose actions may affect the common elements of quality;
- make provision for dealing with non-compliance with those technical and performance standards;
- decide arrangements for ancillary services relevant to the maintenance of common elements of quality;
- decide a methodology for allocating the costs of maintaining particular levels of the common elements of quality; and
- provide a mechanism for amending this arrangement that provides for the CQC's consent to be obtained for any changes except to the governance structure.

An arrangement between members of MACQS and the CQC to the extent that the arrangement does all or any of the following:

- obliges the CQC (which initially will be Transpower) to provide or acquire services necessary to maintain the common elements of quality decided under the overall arrangement;
- commits the CQC to performance objectives decided under the overall arrangement;
- provides that the CQC will enter into security contracts with the entities forming or connected to the national grid or whose actions may affect the common elements of quality; and
- provides a mechanism for amending this arrangement by agreement between the parties.

Individual arrangements (whose contractual form will be security contracts) between the CQC and each entity connected to the national grid or whose actions may affect the common elements of quality, and between the CQC and Transpower as grid

owner, to the extent that the security contracts oblige each such entity to do all or any of the following:

- comply with the technical and performance standards from time to time decided under the overall arrangement;
- be subject to any provision under the overall arrangement for dealing with the non-compliance with those technical and performance standards;
- pay the costs of maintaining the common elements of quality that have been allocated to that entity under the methodology determined under the overall arrangement; and
- have disputes under the security contract resolved in accordance with the dispute resolution process decided under the overall arrangement.

Arrangements between the CQC and the grid owner which oblige the grid owner to use reasonable endeavours to ensure that each person connected to its network enters into a security contract with the CQC to the extent necessary to maintain the common elements of quality determined under the overall arrangement.

Dated this 13th day of August 1999

K M Brown
Member

Appendix A

Multilateral Agreement on Common Quality Standards

Guiding Principles

The **guiding principles** of this contract are that:

1. Continuing availability of electricity at lowest cost

This contract should be consistent with the objective of ensuring the continuing availability of electricity, at the lowest cost to the economy as a whole, consistent with sustainable development;

2. Efficient use of resources

This contract should ensure the efficient use of resources in providing the services necessary to maintain the **common elements of quality** at a quality and quantity that are demanded by the **members**;

3. Unbiased across suppliers

Where there are substitute suppliers of the services necessary to maintain the **common elements of quality**, this contract should not be biased in favour of any one type of supplier;

4. Responsibility for selecting quality and quantity

Members should be responsible for selecting the quality and quantity of services necessary to maintain the **common elements of quality**. These demanded services should be priced in a manner consistent with the Government's pricing principles for electricity as outlined in any statement of economic policy relating to electricity transmission or the **common elements of quality** issued to the Commerce Commission from time to time under section 26 of the Commerce Act 1986;

5. Members to take responsibility

The consequences of poor selection of standards relating to **common elements of quality** should rest with **members**;

6. Customer-specific solutions

While recognising the shared benefits of the **Network**, this contract should (subject to clause 2.2) allow the development of customer-specific solutions to the demand and supply of services necessary to maintain the **common elements of quality**;

7. Evolution of grid security policy to be transparent and unbiased

The process by which this contract evolves should be transparent and not biased in favour of any person and, in particular, should limit the potential for any person to amend this contract in a manner which introduces unjustifiable bias; and

8. Enforceable and binding

This contract should be enforceable by and binding on all parties to it.