

**SUBMISSION FROM MERIDIAN ENERGY LIMITED ON AN
APPLICATION BY THE ELECTRICITY GOVERNANCE BOARD
LIMITED FOR AUTHORISATION OF A RESTRICTIVE TRADE
PRACTICE**

22 February 2002

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SUBMISSION FROM MERIDIAN ENERGY LIMITED ON AN APPLICATION BY THE ELECTRICITY GOVERNANCE BOARD LIMITED FOR AUTHORISATION OF A RESTRICTIVE TRADE PRACTICE

This is a submission by Meridian Energy Limited on the Electricity Governance Board Limited's ("**EGBL**") application for authorisation of a restrictive trade practice relating to a proposed arrangement in respect of the electricity industry. The submission should be read in conjunction with the paper dated 22 February 2002 from Frontier Economics.

(A) SUMMARY

(A1) Meridian's position

- 1 Meridian opposes one part of the application – being Part F of the Rulebook. Meridian opposes authorisation of Part F which, Meridian says:
 - is likely to produce certain anti-competitive outcomes in breach of s27 of the Commerce Act (the "**Act**"); and
 - is likely to perpetuate monopoly pricing by Transpower;

in contrast to the likely outcomes under the counterfactual proposed by Meridian. That counterfactual involves regulation by the Commission of matters covered by Part F, combined with an industry Electricity Governance Board (the "**EGB**") to regulate the other Parts of the arrangement such as the wholesale electricity market, common quality and switching.

Accordingly, Meridian considers that the Commission should decline to authorise the application in its present form, but should indicate that it would authorise it if Part F were deleted.

- 2 Further, Meridian submits that the public benefits identified by EGBL do not outweigh the anti-competitive effects of Part F. Nor does EGBL

acknowledge the serious public detriments that will result from authorisation of Part F.

- 3 Meridian is not opposed to those parts of the proposed arrangement which relate to the wholesale electricity market and provide for common quality obligations and customer switching. However, Meridian has reservations about the governance rules which it wishes to place on record. It further notes that the adoption of a flawed governance model contributes to anti-competitive outcomes and public detriments that are likely to result if Part F is authorised.

(A2) Counterfactual

- 4 Meridian believes that the Commission can consider Part F in isolation from the rest of the Rulebook. There are two reasons for this:
 - the rules in Part F are not functionally necessary to the remainder of the application. As the applicant itself acknowledges Part F has been included principally because of a Government requirement that Transpower's pricing take into account Transpower's natural monopoly characteristics and the effects that its pricing may have on competition, and not because it is an integral part of the Rulebook. Part F is also the only part of the rules which requires the EGB to perform a pricing function. It follows that competitive benefits/detriments and public benefits associated with the remainder of the arrangement can be considered separately from Part F;
 - the Commission's own statutory powers under Part 4A of the Commerce Act extend to the service definition, service level, and pricing function of the EGB under Part F. The Commission not only has these powers but will be exercising them in relation to lines businesses generally.

(A3) Part F will adversely affect competition

- 5 Part F of the Rulebook sets out processes under which Transpower, as the owner of the national grid, and its customers define the services and the levels of service being delivered by Transpower which may be incorporated into Transpower's contracts with its customers. In addition, Part F provides a process by which Transpower determines, and the EGB "confirms", a pricing methodology for its services.
- 6 Meridian considers that, largely because EGBL has used the wrong counterfactual, it fails to properly analyse the competition effects of the pricing provisions and makes no attempt to quantify them. As a result of the way in which the application is structured, Transpower is not being required to justify, or even explain, its pricing methodology. In Meridian's view, Part F is likely to have serious anti-competitive effects by perpetuating existing discriminatory pricing. Meridian's analysis suggests that Transpower's pricing is sending inappropriate locational signals in relation to investment in new generation, which substantially lessens competition in a market for development and construction of new generation plant and in the generation and wholesale market.

(A4) Public detriments

- 7 Neither the Part F pricing principles nor the EGB's processes are likely to produce outcomes that foster competition. EGBL's analysis fails to address serious public detriments which will result from Part F. No details of Transpower's pricing methodology are included in the application, although it is well-developed now. The applicant has made no attempt to quantify the public benefits that it claims. It invites the Commission to accept that a Crown Electricity Governance Board (the "**Crown EGB**") would be less efficient and more susceptible to capture than an industry EGB.

(A5) Institutional competence

- 8 In Meridian's view, the EGB is unlikely to possess the institutional competence to assess either competitive detriments or the extent to which

Transpower is extracting monopoly rents. This results from the flawed accountability of the EGB coupled with its lack of expertise, resources and due process and powers relative to the Commission.

- 9 In summary, Meridian considers that the process by which Transpower's pricing methodology is determined and approved will produce anti-competitive outcomes that are not outweighed by any benefit to the public as required by s61 of the Act. There is an onus on EGBL to identify and quantify both the effects on competition and the public benefits of the arrangement. In Meridian's view EGBL has not discharged that onus.

(B) COUNTERFACTUAL

- 10 EGBL's counterfactual is set out in s17 of its application. Meridian considers that EGBL has adopted the wrong counterfactual for its analysis of Part F.

(B1) EGBL's counterfactual

- 11 EGBL considers that the regulatory counterfactual is the most likely alternative scenario should the industry fail to achieve an agreed (and authorised) set of rules. The counterfactual supposes that, in the absence of industry agreement, the Governor General would, on the recommendation of the Minister, make regulations under the Electricity Amendment Act 2001 to establish a Crown EGB, and to implement the substantive effect of recommendations made by the Crown EGB to the Minister.
- 12 EGBL justifies the adoption of the regulatory counterfactual by referring to political considerations which dictate that the Crown EGB would at least initially adopt arrangements that are materially identical to those proposed by EGBL. Accordingly, the elements of compulsion and "collusion" (dealing with non-participants only on agreed terms) can be dismissed on the grounds that compulsion would follow under regulation.

(B2) Meridian's counterfactual

- 13 Meridian considers that the correct counterfactual is that of authorisation of the proposed arrangement by the Commission without Part F, coupled with control of transmission service definition and pricing by the Commission under Part 4A of the Commerce Act.
- 14 Meridian accepts that, in the complete absence of industry agreement, the Government is most likely to regulate. However, in Meridian's view, the realistic counterfactual concerning Part F is one involving price control by the Commission under Part 4A.
- 15 Part 4A gives the Commission jurisdiction over all the elements of Part F, including those set out in sections I and II as well as transmission pricing. Under s57O of the Act the Minister has an unfettered discretion to require the Commission to make an authorisation in respect of all or part of Transpower's pricing methodology.
- 16 In saying this, Meridian does not suggest that the Commission will need to exercise its powers under s57O in relation to service definition, or that it should do so. Meridian believes that the industry will be able to agree on service definitions and levels, and new investment.
- 17 Authorisation of an amended arrangement, coupled with use of Part 4A of the Commerce Act to address transmission pricing issues, is the more appropriate counterfactual because:
 - Part F is not functionally necessary to the other parts of the application, involving the operation of the wholesale electricity market, switching, common quality standards, and governance. Therefore the Commission is likely to conclude that it would authorise the arrangement without Part F if, as Meridian submits, Part F will or is likely to lead to anti-competitive outcomes, or outcomes that perpetuate monopoly practices by Transpower. The Commission may do so either because of adverse competition effects inherent in Part F or because

of public detriments (relative to the correct counterfactual) that result from regulation of monopoly transmission services by an industry EGB;

- the Government has indicated that it will regulate transmission pricing in the absence of an industry solution, and established the necessary machinery (Part 4A of the Act) to do so. Transpower is already subject to that regime, along with the other lines businesses;
- the Government has already envisaged the counterfactual that Meridian is proposing which anticipates that the Commission may regulate transmission pricing without the need for the Crown EGB. Paragraph 13 of Attachment 1 to the GPS envisaged enactment of s570 of the Act “[a]s a safeguard in case the Governance Board and Transpower are unable to agree on a satisfactory transmission pricing methodology...to ensure that the Government can empower the Commerce Commission to determine the transmission methodology”;
- the Commission has the jurisdiction (as noted above) and institutional competence to regulate transmission pricing. The EGB lacks the ability and independence of the Commission;
- the Commission will be required to set thresholds for Transpower in any event so Meridian’s counterfactual eliminates duplication of resources;
- establishment of a Crown EGB would be unnecessary in the event that the application failed only because of Part F. Consistent with the Government’s preference for industry solutions where possible, it would be likely to promote the counterfactual preferred by Meridian. The industry, for its part, would prefer Meridian’s counterfactual to establishment of a Crown EGB under the Electricity Amendment Act 2001. It could be expected to apply for authorisation of an amended arrangement that excludes those provisions of Part F that relate to transmission pricing.

(B3) Implications of counterfactual

- 18 Meridian strongly disagrees with the applicant's argument that outcomes under EGLB's counterfactual would be essentially similar, at least initially, to those under the arrangement. Under Meridian's counterfactual, outcomes would differ from the outset, in several respects.
- 19 First, the Commission would be directly concerned, as the industry or Crown EGB is not, to ensure that Transpower's pricing did not substantially lessen competition in other markets, and that Transpower did not earn monopoly rents. In the process of doing so, it would ensure that Transpower was exposed to normal business risk; the exercise would not simply be one of allocating Transpower's revenue requirement amongst its customers.
- 20 To elaborate, in making an authorisation under Part 4A, the Commission must have regard to any efficiencies that the Commission considers will result, or will be likely to result, from the exercise of its powers (s57Q). The Commission may also have regard to the extent to which competition is limited or is likely to be lessened in respect of Transpower's goods or services, and the necessity or desirability of safeguarding the interests of persons who acquire or supply the goods or services (s57Q, s70A). There is no corresponding requirement in the pricing principles in Part F.
- 21 Second, unlike the EGB, the Commission would not be confined to a 5 year review in relation to any given service, or be dependent on Transpower (on its own initiative or at the request of purchasers who together pay 50% or more of Transpower's revenue) to initiate a change in service definition or price. The Commission also would not be required to accept minimal compliance with a very general set of pricing principles.
- 22 Third, the Commission is both independent of the industry and competent to perform the regulator's task, in contrast to the EGB.

- 23 Meridian says that the arrangement will produce certain anti-competitive outcomes, or fail to deliver public benefits, relative to the counterfactual. This point is developed further in section (D) below.

(C) RELEVANT MARKETS

- 24 In Decision 446 the Commission defined relevant markets. They include the national electricity generation and wholesale market, the national electricity network contracting services market, and the national market for ownership and operation of new distribution networks.
- 25 Meridian believes that the relevant markets for present purposes are:
- the generation and wholesale market; and
 - the national transmission market.
- 26 There may also be a market for the development and construction of new generation plant. This would be consistent with the High Court decision in *Power New Zealand v Mercury* [1996] 1 NZLR 686, 704. The Court there found that there is a market for construction of new distribution networks. Their ownership and operation, post-construction, fall within the relevant distribution market. By analogy, there should be a market for construction of new generation plant.

(D) ANTI-COMPETITIVE EFFECTS

- 27 Meridian is concerned that, in its current form, Part F will perpetuate discriminatory pricing of transmission services.
- 28 EGBL acknowledges that the main driver for including transport rules in the arrangement is the Government's requirement that the definition of Transpower's services, and the prices that Transpower charges for those services, be dealt with, either by the industry or by regulation. The Government's requirement stems from concerns about transmission's

strong natural monopoly characteristics and the effects that transmission pricing can have on competition.

(D1) Summary of Part F process

Service definition and service measures

- 29 Section I of Part F sets up a process by which existing transmission services contracts will be varied. This section provides the framework for determining current services being provided and how investment to maintain those services will be commenced.
- 30 Transpower proposes a set of service definitions and services measures to the EGB. The EGB refers them to a working group, as well as inviting submissions from other parties. Half of the working group is made up of nominated representatives of Transpower customers who are selected by the EGB. The other half is made up by Transpower.
- 31 The working group considers the proposal and any submissions with a view to recommending a set of service definitions and service measures. The working group must use reasonable efforts to reach unanimous agreement on a recommendation or, if that is not possible, provide a report of the substantial majority.
- 32 The working group's recommendation is then voted on by Transpower and its customers. Voting entitlements on the recommendation are the same as for rule changes (half votes to Transpower and half to Transpower customers allocated on the basis of value of services purchased). A simple majority of each class is required to pass the recommendation. As Transpower has half the votes it can veto any recommendation. If the recommendation is not approved the process is repeated with a new working group. If the recommendation is not approved a second time then final offer arbitration will apply. Once the set of service levels and measures is determined, each customer or group of customers then meets with Transpower to determine the set applicable to that customer or group of customers.

- 33 The services levels determined will immediately bind Transpower's customers if (a) there is a written contract for transmission services (and the parties agree that the section I service levels will apply) or applicable posted terms; and (b) a confirmed pricing methodology has been determined under section III. In other words, although a customer has some input into the process to determine services, the transmission price relevant to that service will immediately bind it and will vary its existing contract with Transpower once a price has been set in accordance with section III of Part F.
- 34 In Meridian's view, the effect of these processes is that Transpower retains a substantial degree of control over service definition.

New investment

- 35 Rule 6 of section I sets out how new investment by Transpower is determined. Transpower must publish a draft service delivery plan each year which identifies how Transpower is to meet the service levels determined above over the next 10 years. If Transpower considers that new investment is required to maintain services levels, then Transpower will include details of the investment options that it is considering.
- 36 Although Transpower's customers can comment on a draft service delivery plan, Transpower is only required to "have regard" to those comments before determining a final plan. Transpower can commit to a new investment unless Transpower's customers have committed to an alternative solution or service levels have been reduced, provided that Transpower is satisfied that the need for investment no longer exists.

New or changed service levels

- 37 Once base service levels are determined under section I (and prices under section III), section II is used to change an existing service level, add a new service or change a condition surrounding a service. Transmission purchasers can vote on proposals introduced by transmission providers.

The proposal must include a confirmed pricing methodology for the service change.

- 38 The extent to which a transmission purchaser can influence the outcome of a proposed service change will depend on how the services are defined in the proposal. The transmission purchasers eligible to vote are those which will receive the new or changed services. Votes are allocated on the basis of how much the transmission purchaser will pay for the new or changed service as a proportion of the total amount to be paid. Any person can appeal to the EGB to reconsider an approved or rejected resolution on the grounds of “benefit to the public” under rule 4.1.

Pricing

- 39 Prior to, or contemporaneous with, submitting a pricing methodology under section III, Transpower must provide its proposed design process and principles to the EGB. Transmission purchasers have the opportunity to make submissions on both the proposed design process and principles. However, as EGBL noted, Transpower is not obliged to revise its design principles and process in response to the submissions made.
- 40 The EGB must then publish the proposed pricing methodology which is based on those design principles. Any person may provide submissions to the EGB, although the grounds on which submissions are able to be made are limited by rule 5.3. The EGB must publish any submissions, and take those submissions into account when it is assessing whether the methodology conforms to the pricing principles and objectives.
- 41 The EGB may decline to consider a pricing methodology where the transmission provider has not provided sufficient information for the EGB to make an informed assessment. The EGB may either confirm the pricing methodology or refer the pricing methodology back to the transmission provider with the reasons why the methodology does not conform to the principles and objectives. The process is repeated until the methodology

is confirmed by the EGB or the transmission provider withdraws from the process.

- 42 In conclusion, the pricing process is driven by Transpower. Except under particular circumstances, pricing review takes place only every 5 years or when Transpower requires it. The test to be applied by the EGB is not whether the pricing methodology optimal but whether it meets a general set of principles against which it must be measured.

(D2) Summary of Meridian’s position

- 43 Meridian’s view is that:

- Transpower’s pricing is currently discriminatory. The justifications offered for that pricing by Transpower are not sustainable, for reasons outlined in Frontier’s paper dated 22 February 2002;
- Transpower’s draft design principles give every reason to suppose that Transpower intends to perpetuate its existing methodology;
- in the event that Transpower does so, the EGB is unlikely to be able to compel it to address the issue. This inability to compel is a result of the general pricing principles, the EGB’s processes (Transpower-driven, minimal compliance suffices), the EGB’s lack of institutional competence and its corporate characteristics, composition and interests.

(D3) Proposed Transpower methodology fails to address competition effects or monopoly pricing

- 44 Under its Statement of Corporate Intent, Transpower is required to ensure that its pricing is consistent with the objectives and principles for the provision of transmission services embodied in the Government Policy Statement (“**GPS**”) issued under section 26 of the Act.
- 45 The Government’s overall objective is to ensure that electricity is delivered in an efficient, fair, reliable and environmentally sustainable manner to all

classes of consumer. Consistent with this overall objective, the Government seeks several specific outcomes. Included in those outcomes is the requirement that delivered electricity costs and prices are subject to sustained downward pressure. Further, in developing rules that are consistent with the GPS, the Government requires that the rules should promote enhanced competition wherever possible and, where it is not, seek outcomes that mirror as far as possible those that would apply in competitive markets.

- 46 In respect of transmission, the GPS recognises that transmission has strong natural monopoly characteristics, and that therefore the Government has taken particular care to set out its policy expectations as to how transmission services should be provided and priced and how Transpower should operate. The Government also recognises that the way in which transmission services are provided and priced impacts directly and indirectly on competition among and investment by suppliers of electricity services, including generators. The GPS accordingly sets out specific pricing principles and guiding principles which Transpower must incorporate into its pricing methodology to ensure that transmission services are priced efficiently and in accordance with the Government's energy policy objectives.
- 47 Meridian considers that Transpower has failed to comply with these important principles, and will continue to do so. There are a number of respects in which Part F makes this almost inevitable.

Process

- 48 First, under Part F Transpower puts forward its own pricing methodology to the EGB as discussed in section (D1). The EGB must then determine whether the pricing methodology conforms to the principles and objectives for transmission set out in the Rulebook. Part F envisages that the EGB must approve if the Transpower-initiated methodology achieves compliance. The EGB does not initiate methodology changes, and its brief

does not extend to insisting on a methodology that it considers optimal. Rather, minimal compliance is enough.

- 49 Of particular note is the fact that the guiding principles in Part A of the proposed arrangement, which attempt to achieve some balance between the competing interests in the industry, are not carried over into Part F. In Part F the EGB is only required to ensure that Transpower's pricing methodology minimally complies with the more limited pricing principles.

Substantive pricing principles

- 50 Second, the principles which the Commission is asked to endorse, and against which the EGB assesses Transpower's methodology, fail to emphasise competition and the need to place downward pressure on Transpower's prices and costs. The transmission pricing principles set out in rule 2.3.1 of section III of Part F are:

- economic costs – after allowing for financial losses and costs properly charged to its shareholders, the transmission provider's charges should recover the "full economic costs" of its services;
- costs of connection – the costs of connection should as far as possible be allocated on a user pays basis;
- investments – the pricing of new and replacement investments should provide transmission purchasers with strong incentives to identify least cost investment options, including energy efficiency and demand management options;
- location signals for new entrants – pricing for new entrants should provide clear locational signals;
- sunk costs – sunk costs should be allocated in a way that minimises distortions to production/consumption and investment decisions made by transmission purchasers;

- pricing structure – the overall pricing structure should include a variable element that reflects the marginal costs of supply in order to provide an incentive to minimise network constraints; and
- the objective (as set out in rule 2.3.2 of Part F) of pricing transmission services is to do so in a manner that is transparent; fully reflects their cost including risk; facilitates nationally efficient supply, delivery and use of electricity; promotes efficient use of the transmission provider's resources; promotes nationally efficient use of transmission services by transmission purchasers and so facilitates efficient resource use.

51 In applying the principles and objectives any conflicts in the principles and objectives are to be resolved in the manner most consistent with the objective of satisfying the electricity requirements of consumers in a manner that is least cost to the economy as a whole and is consistent with sustainable development. The application of the principles and objectives are to take into account practical considerations, transaction costs and the desirability of consistency and certainty.

52 The principles and objectives are general and very broadly stated. They are stated to be based on, and reflect (subject only to necessary modifications), the principles and objectives for the provision of transmission services as set out in the GPS. However, Meridian submits that these principles and objectives do not meet the goals of competition law on the following grounds:

- while the principles and objectives refer to efficiency in general terms, they do not require the pricing methodology to promote competition; and
- the principles and objectives emphasise recovery of Transpower's "full" economic costs. Efficiency is mentioned but the principles fail to emphasise the importance of placing downward pressure on Transpower's costs.

By contrast, the Commission will consider competition and elimination of monopoly rents when setting prices (refer s57Q and s70).

Draft design principles

- 53 Meridian's concerns about the methodology that will be submitted to the EGB are borne out by Transpower's draft design principles dated 25 January 2002. This document concludes that the pricing principles in Part F are not materially different from those in the GPS. It does so, however, by discounting the GPS principles relating to promotion of competition and downward pressure on Transpower's pricing and costs. In particular:
- Transpower concludes that the principle that delivered electricity costs and prices are subjected to sustained downwards pressure is not relevant to its pricing methodology "because forces other than the pricing methodology have a primary influence". It goes on to point to the Commission's regulatory role under the Commerce Act. This confirms that, so far as Transpower is concerned, elimination of monopoly rents is not relevant to its pricing methodology under Part F. Rather, the design principles assume recovery of total costs by Transpower, and focus instead on how these costs are allocated;
 - Transpower also concludes that promotion of enhanced competition is not relevant to its pricing, again because "[f]orces other than the pricing methodology mainly influence this requirement".
- 54 In summary, Meridian believes that Transpower's proposed methodology does not reflect the need to promote competition and place downward pressure on its costs. It is likely that Transpower will seek to perpetuate its existing pricing. For reasons already outlined, the pricing principles and the processes to be adopted by the EGB will not prevent Transpower from doing so, and moreover is likely to facilitate it.

(D4) Effects on competition of existing pricing

- 55 Of particular concern to Meridian is Transpower's pricing of the HVDC link. The HVDC link carries electricity between the North and South Island. It is converted from direct to alternating current at Haywards and Benmore, where it is connected to the remainder of the transmission network. Functionally, it is simply part of the New Zealand transmission system, allowing electricity to flow in either direction according to supply and demand decisions made by generators and consumers throughout New Zealand.
- 56 Since 1996 Transpower has attempted to allocate the cost of the HVDC link in its pricing methodology in such a way that it is paid entirely by South Island generators such as Meridian.
- 57 In marked contrast, transmission services apart from the HVDC link are paid by directly connected customers and lines companies on behalf of retailers. That is, the costs of transmission services in the high voltage AC network are paid by the demand side. Generators pay for connection services. They do not pay for transmission services associated with high voltage AC networks.
- 58 Meridian has estimated that its share of Transpower's transmission charges for the HVDC link in the 2002/2003 year will be approximately \$43,800,000. By comparison, Meridian is expecting to incur other transmission charges of \$6,300,000. Besides being a very significant charge to Meridian on their own, the charges for the HVDC link make up the vast proportion of Meridian's total transmission charges and, aside from any energy purchase costs, are its single largest operating cost.
- 59 Frontier concludes that Transpower's HVDC charges are anti-competitive because:
- they impose a charge for the link on some generators only, despite the fact that the link is merely part of the national grid;

- apart from the HVDC link, generators do not pay for transmission services. Rather, these transmission charges are paid by the demand side;
- payment of all transmission charges by the demand side is preferable because the charges are then broad-based and non-discriminatory, so minimising distortions that may result from sunk cost recovery;
- although locational pricing signals for new generation investment are appropriate, the HVDC charge does not serve the purpose. Further, such signals should be sent to all generators and loads. Failure to do so means that there is an artificial incentive to locate new generation in the North Island. If it is difficult to design charges that send appropriate locational signals, then new investment should be priced on the same basis as other fixed or sunk costs.

60 Meridian considers that the impact on competition in the generation market is likely to be substantial although it is not in a position to quantify it. However, whichever market definition is used, the important point is that the HVDC charge is an important consideration for all generators when making decisions whether and where to build new plant. As Frontier observes, it creates an inappropriate incentive to locate plant in the North Island. It therefore has a significant impact on productive and dynamic efficiency. Meridian would wish to discuss this issue further with the Commission.

(D5) Institutional competence

61 In summary, Meridian believes that Part F is likely to produce status quo outcomes, perpetuating discrimination. This likelihood is confirmed by examination of the institutional competence of and incentives on the EGB, relative to the Commission, to address adverse competition effects or monopoly pricing.

- 62 The EGB is to be made up of seven directors who have the skills and experience prescribed by the Rulebook. EGB members must collectively have:
- experience at a senior level in commercial governance; and
 - technical expertise in electrical engineering (generation, network management and transmission), economics or law; and
 - expertise in distributed generation and/or renewables, energy efficiency and demand side management; and
 - expertise or experience of consumer issues including those of domestic consumers, and consumers' technical issues; and
 - an understanding of commodity markets and their development; and
 - knowledge and experience of the New Zealand power system.
- 63 Meridian makes no criticism of the individuals who will be appointed to the EGB. But it observes that:
- as a practical matter they will require previous industry experience in order to meet the criteria set by the rules. Further, although nominees are initially selected by the EGB for election (and in the initial start up by EGEC), participants are likely to vote for nominees whom they believe will be inclined to favour their perspective. As a result, while EGB members are required by the rules to be independent and act impartially, they cannot be as independent as the Commission. This is especially important when it comes to a question of discrimination, where a remedy may have ramifications for other industry participants;
 - the corporate model of the EGB is oriented to majority rule and does not have either clear non-discriminatory pricing principles nor general oppression of minority principles akin to those in the Companies Act

1993. The likely result is less than optimal or independent of the interests of the majority, and it may have little reference to economic efficiency or pro-competitiveness;

- they are not primarily tasked with handling pricing issues;
- the EGB is unlikely to be adequately resourced by comparison with the Commission, which will be carrying out the same function for other lines businesses (and is already acquiring significant expertise).

64 Of particular concern is the fact that the EGB will be required to address transmission pricing methodology at a very early stage in its life. In fact, approving a pricing methodology is likely to be one of the very first tasks that the EGB has to carry out. The EGB is therefore even less likely to possess the ability to deal with pricing methodology, especially relative to the Commission. Further, unless Transpower requires it to, the EGB will not repeat the exercise for a further 5 years. Therefore it will not be developing expertise over time, unlike the Commission and does not have the ability to revisit outcomes in the short term.

65 Meridian recognises that Transpower will be subject to thresholds set under Part 4A. It believes, however, that those thresholds are likely to operate at a firm level; that is, they will primarily address Transpower's overall revenue requirement rather than how it is allocated. Accordingly, under the applicant's proposal it will be left to the EGB to deal with methodology and allocation.

66 Part F is very different in character to the rest of the proposed arrangement. The proposed arrangement is primarily focused on industry governance and co-operation in areas where co-operation is necessary. Most of these arrangements are already on foot under existing rules and are demonstrably unlikely to have a significant adverse impact on competition. By contrast, section III of Part F is focused on pricing transmission services, a topic in respect of which there will be widely

divergent interests within the industry. It is inherently ill-suited to collective decision-making by the EGB, and it is likely to have significant implications both for competition and for consumer welfare.

- 67 These risks are not considered by EGBL because, under its counterfactual, the alternative to industry regulation is regulation by the Crown EGB. However, it is Meridian's submission that the Crown EGB would face the same issues of institutional competence as the EGB.
- 68 EGBL's counterfactual assumes that a Crown EGB will be less efficient and more susceptible to capture by the Crown. This proposition overlooks the fact that the industry EGB is scarcely less susceptible to Crown influence. There is express statutory provision for accountability of the industry EGB to the Government in sections 172ZK and 172ZM of the Electricity Amendment Act 2001. Under those sections, the industry EGB must agree performance standards with the Minister at the beginning of each year, and then report to the Minister on its operations during that year "to enable assessment to be made of the performance of the [EGB] against the GPS objectives and outcomes...and the performance standards". Further, the Rulebook expressly acknowledges the requirement to comply with the GPS (refer Foreword to the Rulebook).
- 69 By contrast, under Meridian's counterfactual, the Commission is uniquely qualified to regulate transmission pricing. It is already experienced in competition analysis and price setting, and has the resources and experience necessary to equip it for a price setting role. Importantly, it would be completely independent from the industry.

(E) RELATIONSHIP OF PART 4A OF COMMERCE ACT TO INDUSTRY EGB

- 70 The applicant submits that Part 4A will still be available in the event that its counterfactual is adopted and the Commission authorises Part F. It adds that the Commission is not authorising particular outcomes, so that

industry participants could still invoke Part II of the Commerce Act in relation to any given set of transmission prices.

71 Meridian's response is that:

- Part F is highly likely to produce anti-competitive outcomes – therefore the Commission should not even consider authorising it;
- if Part F is authorised it will delay at considerable cost and for a competitively significant period the exercise of the Commission's powers to define services and allocate Transpower's revenue requirement among its customers. Government, and the Commission, will wait and see how Part F operates in that case. By contrast, if the Commission rejects Part F on competition grounds, the Commission's powers will be invoked without further delay.

72 With respect to the first of these points, Meridian's submissions (section (D) above) demonstrate that Part F is likely to perpetuate both discrimination and monopoly pricing. This can be predicted from: the substantive principles that the EGB will apply, which in combination with Transpower's draft pricing principles demonstrate a degree of indifference to competitive implications of transmission pricing; the EGB's processes (reactive to Transpower initiatives and obliged to accept any proposal that achieves minimal compliance); and institutional competence of and incentives on the EGB relative to the Commission.

73 With respect to the second point, the Commission normally considers that the relevant time frame for assessing competition effects is at least one year.¹ Meridian submits that it is readily foreseeable that authorisation of Part F would delay regulation under Part 4A of the Commerce Act, apart

¹ Practice Note 4: The Commission's Approach to Adjudicating on Business Acquisitions under the Changed Threshold in s47-A Test of Substantially Lessening Competition.

from the imposition of thresholds, by at least that length of time.

Authorisation of Part F would involve a de facto authorisation of any given methodology and prices, because Transpower would be relieved of the burden of seeking authorisation for any given set of prices that it had agreed on with its customers. Rather, Transpower would be in the position of placing the onus on the Commission, or other industry participants, to show in hindsight why the Commission should intervene. Delays of 1-2 years are highly likely in addition to the costs of the Part F process.

- 74 Further, any participant seeking to litigate outcomes under Part II is likely to be faced with a claim that the outcomes comply with a set of pricing principles that have been endorsed by the Commission. It is at this point that the rather indefinite scope of the authorisation becomes problematic. The Commission is asked to authorise Part F on the (undeveloped) assumption that it will produce appropriate outcomes. In other words, so long as the methodology has been found by the EGB to achieve minimal compliance, Transpower will be able to argue that it complies with a set of pricing principles that the Commission has authorised. This will create a significant additional barrier to litigation under Part II. Such litigation, as the Commission knows, is already difficult and costly.
- 75 By way of elaboration, Meridian notes that Part F has quite different features from other Parts of the arrangement. Many of the rules raise few if any competition concerns. Rather, they are necessary for the operation of electricity markets. For that reason such rules should be very responsive to industry needs. Further, such rules may require relatively frequent alteration at a level of detail. Section III of Part F does not share these characteristics. Rather, the rules only require Transpower to seek approval of pricing methodologies once every five years. Section III of Part F, as outlined above, also raises serious questions regarding its impact on competition and efficiency of transmission pricing.

76 It is for this reason that Meridian submits that EGBL invites the Commission to license monopoly pricing by Transpower. It is a premise of the Commerce Act that competition produces outcomes that are efficient in allocative, productive, and dynamic senses. It follows as a matter of logic that the Act also presumes that monopolies will not produce these outcomes. Meridian submits that it would be particularly inappropriate for the Commission to authorise Part F when the alternative is regulation under Part 4A, which would seek to emulate competitive disciplines.

(F) PUBLIC BENEFITS

77 If the Commission accepts Meridian's submission that Part F breaches s27, it must then go on to consider whether there are public benefits which outweigh its detriments.

(F1) EGBL's proposal identifies no public benefits

78 EGBL's analysis of detriments and public benefits of the Rulebook is set out in sections 31 and 32 of the application. While EGBL allows that there is a theoretical detriment due to the deemed substantial lessening of competition under s30, EGBL ultimately submits that no actual detriment arises relative to the counterfactual. It relies on greater efficiency of industry regulation relative to the Crown EGB. But EGBL relies on the wrong counterfactual here. The same arguments do not apply to the Commerce Commission.

79 EGBL identifies a limited number of public benefits of the proposed arrangement. Most of those benefits relate to increased efficiency and reduced risk of capture by major industry players, or the risk of short term decision making by the Crown EGB.

80 Meridian submits that most of the public benefits identified by EGBL are irrelevant or misconceived when applied to Part F. Benefits of the arrangement are attributable to those Parts of the Rulebook relating to the wholesale market, common quality, and switching. Industry self-

governance is an appropriate model for these functions. But any benefits of the arrangement are not attributable to Part F. On the contrary, Part F creates public detriments to which the applicant fails to attach any weight.

81 Meridian submits that, when Part F is considered apart from the rest of the arrangement, there are no public benefits:

- The EGB will have to follow the thresholds set by the Commission, so will perform no useful function to the extent that the Commission sets limits on Transpower's behaviour;
- Part F involves very high transaction costs associated with the process of service definitions, service level, and new investments;
- There will be some duplication of compliance costs because both the EGB and the Commission will have a role in pricing.

82 In the result, EGBL fails to identify or quantify the public benefits and detriments that are associated with Part F.

(F2) Meridian's assessment of public benefits

83 It is Meridian's submission that there are significant detriments in terms of the likely anti-competitive effects of Part F, and if Meridian's counterfactual is accepted, relative to that counterfactual. Some of these detriments arise from Part F itself. Others relate to the weak, and inappropriately mixed, accountability of the EGB relative to the Commission.

84 Meridian submits that a key detriment is that Part F fails to address discrimination, and will delay regulation by the Commission. It is Meridian's assumption that initially the Commission will focus instead on setting thresholds that govern Transpower's overall revenue requirement. If so, Transpower's pricing methodology will be governed by section III of Part F.

- 85 Discrimination has the effect of inhibiting or preventing gains in productive or dynamic efficiency by sending inappropriate locational signals.
- 86 Meridian's concerns about governance apply to both the industry and Crown EGB's. The weaknesses in the structure of the EGB relative to the Commission were discussed in section (D) above. In particular, the make up of the EGB means that it is particularly unsuited and not incentivised to determine and deal with competition and monopoly issues. Areas of particular concern are the prospect of industry capture of the EGB due to its likely make up, and the EGB's inability to take steps to prevent Transpower imposing monopoly pricing due to the weaknesses in the voting and approval processes in Part F.
- 87 Further, although in theory individual participants, or the Commission itself, may initiate proceedings under Part II of the Act in respect of any given pricing methodology, as discussed in section (E) above such litigation is likely to be faced with significant obstacles. Again, significant delays are likely both in identifying discriminatory pricing, and in initiating and progressing proceedings. A further element to be taken into account is the substantial cost involved in litigation, thus imposing further inefficiencies on the process which could be eliminated by the Commission under Part 4A.
- 88 Lastly, but importantly, a further detriment is the duplication of resources arising from the EGB attempting to replicate the Commission's functions. As discussed in section (D) above, the Commission is already experienced in competition analysis and price setting, and has the resources, powers (in relation to evidence and remedies) and experience necessary to equip it for a price setting role. It is already required under Part 4A to identify price control thresholds for lines businesses. The additional cost and loss of efficiency caused by the duplication of roles cannot be outweighed by any public benefits identified by EGBL.

(G) OUTCOMES

- 89 In conclusion, Meridian submits that the Commission should not authorise the proposed arrangement in its current form, but should indicate that it would do so if Part F were deleted.

Dated: _____