



COMMERCE COMMISSION

Decision No. 338

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

AUCKLAND INTERNATIONAL AIRPORT LTD

The Commission:

K M Brown
E C A Harrison
E M Coutts
P R Rebstock

Commission Staff:

D R Ainsworth
V E Healy
P D Woolley
A J Brice

**Summary of Application
Application:**

Auckland International Airport Ltd, which is involved in an electricity lines business and an electricity supply business, seeks an exemption, pursuant to section 81 of the EIR Act, from the application of the ownership separation provisions of the EIR Act.

Determination:

The Commission, pursuant to section 81, declines to exempt Auckland International Airport Ltd from the application of the EIR Act in relation to a prohibited cross-involvement.

Date of Determination:

4 March 1999

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BRACKETS []**

CONTENTS

INTRODUCTION	3
AUCKLAND INTERNATIONAL AIRPORT LTD	3
AIAL’S ELECTRICITY LINES BUSINESS.....	3
AIAL’S ELECTRICITY SUPPLY BUSINESS.....	4
AIAL’S ELECTRICITY GENERATION EQUIPMENT.....	4
INVOLVEMENTS	5
ELECTRICITY LINES BUSINESS.....	5
ELECTRICITY SUPPLY BUSINESS.....	5
PROHIBITED CROSS-INVOLVEMENT	6
COMMISSION PROCEDURES	6
GENERAL.....	6
CRITERIA USED BY THE COMMISSION TO CONSIDER EXEMPTION APPLICATIONS.....	6
RELEVANT MARKETS	8
AIAL’S ARGUMENTS	8
EXAMINATION IN TERMS OF THE COMMISSION’S CRITERIA	9
INCENTIVES OR OPPORTUNITIES TO INHIBIT COMPETITION IN THE ELECTRICITY INDUSTRY.....	9
INCENTIVES OR OPPORTUNITIES TO CROSS-SUBSIDISE GENERATION ACTIVITIES.....	10
A RELATIONSHIP NOT AT ARMS LENGTH.....	10
THE COMMISSION’S DECISION	11
APPENDIX 1: AIAL’S ELECTRICITY PRICING SCHEDULE	12

INTRODUCTION

- 1 The Commerce Commission (the Commission) has received an application from Auckland International Airport Ltd for exemption from the application of the EIR Act. The application was dated 5 February 1999.
- 2 The Commission's powers to exempt businesses, involvements or interests from the application of the EIR Act or persons from compliance with any provisions of any regulations made under the EIR Act are specified in section 81 of the EIR Act.

AUCKLAND INTERNATIONAL AIRPORT LTD

- 3 Auckland International Airport Ltd (AIAL) is a public company listed on the New Zealand Stock Exchange. It owns and operates Auckland Airport (the Airport). Its major shareholders are the Auckland, Manukau and North Shore City Councils together with several companies holding shares as nominees on behalf of other parties. AIAL has approximately 62,000 shareholders.
- 4 AIAL has one wholly owned subsidiary, Waste Resources Ltd and is a joint venture partner in Marriott – AIAL Ltd. The former company owns and operates waste incineration equipment at the Airport and the latter is involved in the provision of food services at the Airport.

AIAL's Electricity Lines Business

- 5 AIAL owns an electricity distribution network (network) at the Airport. This network operates at 11,000 and 400 volts and comprises transformers, switchgear and underground cables. The network connects to Mercury Energy Ltd's (Mercury) citywide network at the perimeter of the land owned by AIAL at the Airport. AIAL is a lines customer of Mercury.
- 6 AIAL informed Commission staff that its network has a depreciated replacement value of about \$[] million.
- 7 AIAL's network distributes electricity from the points of interconnection with Mercury's network to all parties which lease land from AIAL in order to base their operations at the Airport. There are [] electricity consumers at the Airport which include AIAL's own operations, Air New Zealand's jetbase, Airways Corporation of New Zealand's control tower and runway lights, Flight Catering Organisations, New Zealand Post and many small electricity consumers (eg: banks, rental car companies, food outlets, flower or book shops, etc). In 1998 approximately 69 gigawatt-hours of electricity was distributed by AIAL. About 22 gigawatt-hours of this amount is consumed by AIAL's own operations at the Airport.
- 8 AIAL derives its line charges to the consumers connected to its electricity distribution network by allocating the line charge it pays to Mercury amongst those consumers and adding an additional line charge for the use of its own distribution assets. The two charges are bundled together on consumers' accounts. The revenue which AIAL derives from its electricity distribution network is anticipated to be about [] million during this year.

9 [

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10 AIAL does not provide returns to the Ministry of Commerce for the purposes of the Electricity (Information Disclosure) Regulations 1993.

AIAL's Electricity Supply Business

11 AIAL also retails electricity. AIAL has negotiated an electricity purchase contract with TrustPower Ltd. It on-sells the electricity it purchases under that contract to all but two of the consumers¹ connected to its network at the Airport. AIAL [] TrustPower charges it, to establish the electricity prices which Airport electricity consumers pay.

12 AIAL retails about [] gigawatt-hours of electricity per annum to 105 consumers at the airport.

13 AIAL has recently negotiated [] year electricity supply contracts (which includes the provision of electricity lines services and electricity supply) with approximately half of the electricity consumers at the Airport. As a result of the lower prices negotiated as part of AIAL's electricity purchase contract with TrustPower, AIAL has been able to reduce its prices to the consumers which it supplies and these prices have been included in the new supply contracts (see Appendix 1). However, some Airport electricity consumers have not yet signed the new contracts and continue to pay the previous higher prices. The revenue which AIAL expects to derive from its electricity supply business this year is \$[] million.

14 The electricity supply contracts between AIAL and Airport electricity consumers contain a provision which allows AIAL to transfer or assign its rights and obligations under the supply contracts at any time.

15 AIAL does not retail electricity to [] sites at the Airport. Instead TrustPower retails to those consumers. It carries out this function via the mechanism of use of system agreements it has negotiated with both Mercury and AIAL for the use of their electricity distribution networks. Therefore, TrustPower is a retailer to both AIAL and [].

16 AIAL's electricity pricing schedule is attached as Appendix 1.

AIAL's Electricity Generation Equipment

14 AIAL has installed electricity generation equipment to operate vital airport services in the event of electricity supply from Mercury's network failing. [] The total nameplate capacity of all generation on site is less than 5 megawatts.

¹ []

INVOLVEMENTS

Electricity Lines Business

- 17 AIAL is the owner of an electricity distribution network. In terms of the EIR Act it:
- owns a business that conveys electricity by line in New Zealand (s4(1)(a));
 - owns and operates, directly, lines in New Zealand and other core assets of an electricity lines business (s4(1)(b)); and
 - has no activities exempted by section 4(2).
- 18 AIAL:
- carries on an electricity lines business alone or together with associates (s7(1)(a));
 - exceeds the 10% threshold in terms of control and equity return rights in that business (s7(1)(b)); and
 - has material influence over that business (s7(1)(c)).
- 19 Therefore AIAL is involved in an electricity lines business in terms of the EIR Act. AIAL agrees with this interpretation in its application for exemption.

Electricity Supply Business

- 20 AIAL in terms of the EIR Act:
- sells electricity in New Zealand (s5(1)(a)(i));
 - owns and operates directly a generator in New Zealand;
 - owns and operates directly core assets of an electricity retail business which include a customer data base relating to and used for the purposes of an electricity retail or electricity trading business and the benefit of contracts to sell electricity (s5(1)(c));
 - has no activities exempted by section 5(2); and
 - is exempted by section 5(3) only in respect of its generation activities.
- 21 AIAL:
- carries on an electricity supply business alone or together with associates (s7(1)(a));
 - exceeds the 10% threshold in terms of control rights in that business (s7(1)(b)); and
 - has material influence over that business (s7(1)(c)).
- 22 Therefore, AIAL is also involved in an electricity supply business in terms of the EIR Act. AIAL agrees with this interpretation in its application for exemption.

PROHIBITED CROSS-INVOLVEMENT

23 Section 17 provides:

- “(1) No person involved in an electricity lines business may be involved in an electricity supply business.
- (2) No person involved in an electricity supply business may be involved in an electricity lines business.”

24 AIAL is involved, and wishes to remain involved, in both an electricity lines and an electricity supply business. AIAL will, in terms of section 17 of the EIR Act, have a prohibited cross-involvement.

25 AIAL has therefore applied to the Commission for exemption from the application of the EIR Act and, in particular, from the requirement to comply with the ownership separation provisions of the EIR Act.

COMMISSION PROCEDURES

General

26 For the purpose of considering this application, the Commission, pursuant to section 58 of the EIR Act which applies section 105 of the Commerce Act 1986 to the EIR Act, has delegated its powers under section 81 of the EIR Act to K M Brown, E C A Harrison, E M Coutts and P R Rebstock.

27 The Commission’s decision is based on an investigation conducted by its staff and their subsequent advice to the Commission.

28 During their investigation into the application, Commission staff interviewed and obtained information from:

- AIAL;
- TrustPower;
- Wairoa Power Ltd;
- Qantas Airways Ltd;
- the Ministry of Commerce;
- Airways Corporation of New Zealand; and
- Air New Zealand Ltd.

Criteria Used by the Commission to Consider Exemption Applications

29 The EIR Act gives the Commission wide powers of enforcement, extension and exemption. To provide assistance to parties affected by the EIR Act, the Commission set out its role and processes in Practice Note No.3.²

² Practice Note No.3, September 1998, Electricity Industry Reform Act 1998 Commission’s Role and Processes.

30 The Commission stated in Practice Note No.3 that:

“The EIR Act provides for the Commission to make exemptions in terms of section 81 of the EIR Act. In considering applications for exemptions, the Commission will have specific regard to the particular purpose of Parts 1 to 5 of the EIR Act as defined in section 2(2) of the EIR Act. The Commission is likely to grant an exemption in respect of a business or involvement or interest only where doing so:

- (a) would not result in certain involvements in electricity lines businesses and electricity supply businesses which may create incentives or opportunities:
 - (i) to inhibit competition in the electricity industry; or
 - (ii) to cross-subsidise generation activities from electricity lines businesses; and
- (b) would not result in relationships between electricity lines businesses and electricity supply businesses which are not at arms length.

In determining exemptions, the Commission will also have regard to the overall purpose of the EIR Act as set out in section 2(1) of the EIR Act. That is, to reform the electricity industry to better ensure that:

- (a) costs and prices in the electricity industry are subject to sustained downward pressure; and
- (b) the benefits of efficient electricity pricing flow through to all classes of consumers by –
- (c) effectively separating electricity distribution from generation and retail; and
- (d) promoting effective competition in electricity generation and retail.”

31 The Commission noted in Practice Note No.3 that:

“the EIR Act provides for maximum cross-ownership limits and specific structural and behavioural requirements to ensure that the purposes of the EIR Act are met. Strict compliance with these limits and requirements is, other than in exceptional circumstances,⁽³⁾ expected.”

32 The Commission stated in Practice Note No.3 that:

“On receipt of an application the Commission will determine whether granting an exemption would be contrary to any element of the particular purpose of Parts 1 to 5 of the EIR Act or the overall purpose of the EIR Act.

The Commission’s tests would necessitate obtaining and evaluating objective answers to the following three questions in relation to the particular purpose of Parts 1 to 5 of the EIR Act:

- Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to inhibit competition in the electricity industry?;
- Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses?; and
- Would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between an electricity lines business and an electricity supply business which is not at arms length?

In relation to these questions, the Commission will consider factors such as:

- Relevant markets within the electricity industry;
- The nature of any incentives or opportunities created;
- The temporal nature of any incentives or opportunities created;
- The nature of any relationship which is not at arms length; and
- The temporal nature of any relationship which is not at arms length.”

³ For example, of the types provided for in section 19 of the EIR Act.

RELEVANT MARKETS

- 33 The national electricity retail market is relevant to the application of the Commission's criteria to the facts of AIAL's application for exemption.⁴

AIAL'S ARGUMENTS

- 34 AIAL argues that the Government's concerns which prompted the enactment of the EIR Act arose from the activities of electricity companies rather than businesses such as AIAL. In AIAL's view the use of the expression "electricity industry" in the short title of the EIR Act is a reference to electricity companies, rather than a company such as AIAL.
- 35 AIAL accepts that, in terms of electricity distributed, its electricity lines business is of the same order of size as some of the smaller electricity companies and that in complying with the EIR Act those electricity companies have been required to separate their electricity lines and supply businesses.
- 36 However, according to AIAL, the crucial difference between an electricity company and itself in respect of the application of the EIR Act is that electricity distribution and retailing were the principal businesses of electricity companies prior to ownership separation, whereas the principal businesses of AIAL are related to the facilitating and servicing of aircraft and passenger arrivals and departures. Therefore AIAL believes that it has less motive to act in a manner contrary to the purposes of the EIR Act than an electricity company as it has less to gain in terms of overall income.
- 37 AIAL argues that a further distinction between itself and an electricity company is that AIAL's electricity related activities are confined to one site and that it has no interest in distributing or supplying electricity to consumers outside that site.
- 38 AIAL states that it is competing for lessees of its land at the Airport⁵ with other industrial parks in Auckland.⁶ It stated that a surprising number of activities normally associated with the Airport can be carried out off-site if the incentives for businesses to operate at the Airport are awry. AIAL argues that given its wish to expand its land leasing activities at the Airport, it does not have the ability to over charge in respect of its electricity prices if it wishes to attract new tenants to Airport land.
- 39 AIAL argues that as a result of the large volume of electricity consumed by itself and the electricity consumers it supplies, it has the ability to negotiate and has negotiated very low electricity prices. It says that its ability to do this is greater than that of its electricity customers acting individually. AIAL states that the electricity prices it charges its electricity consumers are competitive and are constantly renegotiated.

⁴ Other markets in the electricity industry, for example the local distribution market, wholesale electricity market, the electrical construction and maintenance market and the market for the reticulation of new subdivisions, do not appear to be relevant to this application for exemption.

⁵ AIAL informed Commission staff that it has substantial land at the airport which it wishes to lease to businesses seeking to establish themselves at the Airport.

⁶ In this respect the Airport Oaks Industrial Park was particularly mentioned by AIAL. Already located on that site, a short distance from the Airport, are freight forwarders, rental car companies, some flight catering operations and Customs activities.

- 40 Therefore AIAL argues, the purposes of the EIR Act are being achieved without the need for ownership separation of its electricity line and supply businesses.

EXAMINATION IN TERMS OF THE COMMISSION'S CRITERIA

Incentives Or Opportunities To Inhibit Competition in the Electricity Industry

- 41 Given, the absence of competition issues in electricity generation markets and local distribution markets arising from AIAL's application for exemption, the focus shifts to that part of the national electricity retail market comprising the consumers at the Airport and whether an exemption would provide AIAL with incentives or opportunities to inhibit competitive electricity supply to them.

- 42 The Commission notes AIAL's argument that it was the intent of Parliament, in enacting the EIR Act, to remedy behaviour by electricity companies and that, given AIAL is not such a company, the EIR Act need not be applied to it with its full rigour. However, the Commission notes that the EIR Act defines the activities of lines and supply businesses. If AIAL's activities fall within these definitions, the EIR Act will apply, regardless of any other businesses that AIAL may operate.

- 43 In respect of incentives to inhibit competitive electricity supply to Airport consumers, [

] Therefore, an incentive exists for AIAL to inhibit competition in order to retain the revenue levels which these margins provide.

- 44 In respect of opportunities to inhibit competitive electricity supply, Parliament, in enacting the EIR Act, recognised that the market power of an electricity distribution business provides varied mechanisms to inhibit competition in electricity retailing. Indeed the Commission's experience during five years of investigations into complaints alleging anti-competitive behaviour by electricity companies tends to confirm the existence of such mechanisms. These include:

- charges to retailers for network access and contract administration charges over and above line charges;
- cross-subsidies from line charges to electricity charges; and
- delays in permitting access through use of system agreement contractual arrangements.

- 45 The Commission has received the following information from [] which illustrates the use of these opportunities:

- [

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- 46 AIAL does not disclose to the Ministry of Commerce for the purposes of the Electricity (Information Disclosure) Regulations 1993. It apparently relies on the exemption for electricity companies which have less than 25 kilometres of high voltage line.⁷ As a result, under present proposals, AIAL will not be subject to the electricity distribution price control regime presently being put in place by the Government.⁸ It appears to the Commission that the absence of this potential constraint on its line charges provides AIAL with additional opportunities to put in place cross-subsidies. These cross-subsidies could allow it to lower its contestable electricity prices below levels which permit entry by competitors, by increasing its electricity lines charges to retain overall revenue levels.⁹
- 47 AIAL argues that it must offer competitive electricity prices in order to attract lessees of its industrial land at the Airport. The Commission notes in respect of this argument that:
- electricity is often a very small component of the costs of a commercial or industrial enterprise. Electricity pricing is unlikely to be a major determinant when companies make location decisions;
 - there is nothing to prevent AIAL differentially pricing electricity to prospective new tenants and subsequently raising prices once operations are established at the Airport; and
 - in spite of this claim AIAL has recently introduced its new pricing regime in which [] to other consumers not supplied by AIAL

Conclusion On Incentives Or Opportunities To Inhibit Competition

- 48 The Commission concludes that the granting of an exemption from the application of the EIR Act, and in particular the requirement to comply with the ownership separation provisions will provide AIAL with incentives or opportunities to inhibit competition in the national retail electricity market.

Incentives or Opportunities to Cross-subsidise Generation Activities

- 49 For the purposes of the EIR Act, Parliament has decided that generation activities whose nameplate capacity is less than 5 megawatts should be disregarded.¹⁰ Given that AIAL's generation capacity is below that figure, this criterion is not relevant to the Commission's decision.

A Relationship Not at Arms Length

- 50 AIAL proposes to continue to own and operate both an electricity lines business and an electricity supply business. The two businesses will have common directors, managers, premises and records. Directors and managers will make decisions about both line and supply pricing and also about the terms for the granting of access to AIAL's electricity distribution network by electricity retailers who wish to compete

⁷ Although in its application for exemption it described its network as "about 25 kilometres in length".

⁸ Information supplied by the Ministry of Commerce.

⁹ This was one cause of action in the Commission's case in its prosecution of Southpower Ltd for breach of sections 27 and 36 of the Commerce Act 1986. .

¹⁰ Section 5(3).

with AIAL's electricity supply business. The relationship between AIAL's electricity lines and supply businesses will not be at arms length.

THE COMMISSION'S DECISION

- 51 Therefore, AIAL's application fails on two of the three criteria used by the Commission to decide upon exemptions from the EIR Act. The third criterion is not applicable.
- 52 If AIAL retains ownership of both its electricity line and supply businesses it will result in a cross-involvement in an electricity lines and an electricity supply business in apparent contravention of section 17 of the EIR Act. In the Commission's view, Parliament, in enacting the EIR Act, decided that, despite arguments of the type advanced by AIAL, cross-involvement in the two types of business was undesirable and should be prohibited, save in special circumstances.
- 53 The Commission considers that AIAL has substantial electricity lines and supply businesses. AIAL's electricity businesses are of a similar magnitude in capital value and distribution capacity to the smaller of the electricity companies. It is immaterial to AIAL's electricity customers whether or not the provision of electricity is a major or minor part of AIAL's business.
- 54 AIAL submits that it is not necessary to have ownership separation in order to achieve the purposes of the EIR Act. The Commission has not been satisfied by AIAL's arguments in this instance.
- 55 The Commission, pursuant to section 81, declines to grant an exemption from the application of the EIR Act, and in particular from the requirement to comply with the ownership separation provisions of the EIR Act.

Dated this 4th day of March 1999

The Commission

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12

APPENDIX 1: AIAL'S ELECTRICITY PRICING SCHEDULE

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