



## COMMERCE COMMISSION

### Decision 458

Determination under the Electricity Industry Reform Act 1998 (“the EIR Act”), in the matter of an application for exemption of involvements in both an electricity lines business and an electricity supply business from the application of the EIR Act. The application is made by:

#### **CAPITAL PROPERTIES LIMITED**

**The Commission:** PR Rebstock  
D Curtin

**Commission Staff:** DH Shaharudin

**Summary of Application:** Capital Properties New Zealand Limited and its subsidiary Capital Properties (Wellington) Limited, seek an exemption under section 81 of the EIR Act, from the application of section 17 of the EIR Act.

**Determination:** The Commission, pursuant to section 81 of the EIR Act, exempts Capital Properties New Zealand Limited and its subsidiary Capital Properties (Wellington) Limited from the application of section 17 of the EIR Act in relation to a prohibited cross-involvement in an electricity lines and an electricity supply business. The exemption is subject to the conditions stated in this decision.

**Date of Determination:** 13 March 2002

**Date of Exemption:** On publication of the Notice of Exemption in the *New Zealand Gazette*.

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## **INTRODUCTION**

- 1 On 21 December 2001 the Commerce Commission (“the Commission”) received an application from Capital Properties New Zealand Limited (“CPNZ”) and its subsidiary Capital Properties (Wellington) Limited (“CPW”) for exemption from the application of section 17 of the EIR Act. CPNZ also seeks exemption in relation to future property investment matters.
- 2 CPNZ has sought an exemption for itself and CPW from the application of section 17 of the EIR Act in respect of cross-involvements in electricity lines and electricity supply businesses. These cross-involvements arise as a result of CPNZ and CPW’s ownership of electricity lines within commercial property in Auckland and Wellington together with the sale of electricity to tenants of that property. Section 17 prohibits any person involved in an electricity lines business from being involved in an electricity supply business and vice versa. Those businesses are defined in sections 4 and 5 of the EIR Act.
- 3 The Commission’s powers to exempt any 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 pursuant to section 81 of the EIR Act.

## **CAPITAL PROPERTIES NEW ZEALAND LIMITED**

- 4 CPNZ operates a property investment business. It conducts its business through four wholly owned subsidiaries. It invests in CBD office buildings in Auckland and Wellington. CPNZ also has a fifth wholly owned subsidiary, Capital Properties Management Limited. This company solely operates as a property management company.
- 5 Many of the buildings owned by CPNZ were wired in such way that there was one point of connection to the building from the electricity distribution network. In those circumstances where there was more than one tenant, their power usage required sub-metering.
- 6 In total, around [ ] GWh is transmitted through the wire of CPNZ’s buildings. Until November 2001 less than 2.5 GWh was on-charged by CPNZ. The balance was on-charged through a deal with TrustPower.
- 7 The contract with TrustPower required it to invoice CPNZ’s tenants individually. To accomplish this required a considerable adjustment to its invoicing system.
- 8 The contract with TrustPower expired in October 2001. TrustPower is understood not to be interested in renewing this contract due to the complexities involved in the invoicing system.

## **CPNZ AND CPW’S ELECTRICITY LINES BUSINESSES**

- 9 CPNZ owns and operates electricity lines in New Zealand, those lines being the electrical reticulation within the company’s properties. CPNZ conveys approximately [ ] GWh to tenants of its properties.

- 10 Of its four subsidiaries only one – CPW – supplies more than 2.5GWh per annum to its tenants.

### **CPNZ AND CPW'S ELECTRICITY SUPPLY BUSINESSES**

- 11 CPNZ sells approximately [ ] GWh of electricity to its tenants.

### **INVOLVEMENTS**

#### **Electricity Lines Businesses**

- 12 Section 4(1) of the EIR Act sets out the definition of an electricity lines business.

- 4(1) For the purposes of this Act, electricity lines business –
- (a) Means a business that conveys electricity by line in New Zealand: and
  - (b) Includes the ownership or operation, directly or indirectly, of lines in New Zealand or any other core assets of an electricity lines business.

- 13 CPNZ and CPW are owners of electricity lines in New Zealand in that they:

- own a business that conveys electricity by line in New Zealand (s4(1)(a)); and own and operate, directly or indirectly, lines in New Zealand and other core assets of an electricity lines business (s4(1)(b)).

- 14 Section 4(2) of the EIR Act sets out exclusions from the definition of electricity lines business. Section 4(2)(a), as the only possibly relevant exclusion, provides that:

- 4(2) None of the following activities brings a person within subsection (1):
- (a) Conveying, together with its associates (if any), less than 2.5 GWh per annum:
- CPNZ and CPW convey more than 2.5 GWh per annum and therefore do not fall within the section 4(2)(a) exclusion from the definition of electricity line business.

- 15 CPNZ and CPW are, therefore, electricity lines businesses in terms of the EIR Act.

- 16 Section 7 sets out the definition of involved.

- 7(1) For the purposes of this Act, a person is involved in an electricity business if the person-
- (a) Carries on that business, either alone or together with its associates and either on its own or on another's behalf; or
  - (b) Exceeds the 10% threshold in Section 8 in respect of that business; or
  - (c) Has material influence over the business.

- 17 CPNZ and CPW are involved in an electricity lines business in that they carry on electricity lines businesses (s7(1)(a)).

## Electricity Supply Business

18 Section 5(1) of the EIR Act sets out the definition of electricity supply business.

- 5(1) For the purposes of this Act, electricity supply business-
- (a) Means a business that-
    - (i) sells electricity in New Zealand:
    - (ii) Sells financial hedges for risks relating to the price of electricity in New Zealand:
    - (iii) Generates electricity in New Zealand:
    - (iv) Trades in rights to sell or generate electricity in New Zealand; and
  - (b) Includes the ownership or operation, directly or indirectly, of a generator in New Zealand or any other core generation assets:
  - (c) Includes the ownership or operation, directly or indirectly, of any core assets of an electricity retail business, which include-
    - (i) The customer database relating to and used for the purposes of an electricity retail or electricity trading business; and
    - (ii) The benefit of a contract to sell electricity; and
    - (iii) The benefit of an undertaking from any other electricity supply business not to compete with the business.

19 CPNZ and CPW sell electricity in New Zealand (s5(1)(a)(i)). Section 5(2) of the EIR Act sets out the exclusions from the definition of electricity supply business. Section 5(2)(a), as the only possibly relevant exclusion, provides that:

- 5(2) None of the following activities brings a person within subsection (1):
- (a) Selling or generating less than 2.5 GWh per annum:

CPNZ and CPW each supply more than 2.5 GWh per annum and therefore do not fall within the section 5(2)(a) exclusion from the definition of electricity supply business.

20 Therefore, CPNZ and CPW are electricity supply businesses in terms of the EIR Act. CPNZ and CPW are also involved in electricity supply businesses in terms of the EIR Act in that they carry on an electricity supply businesses (s7(1)(a)).

## PROHIBITED CROSS-INVOLVEMENT

21 Section 17 of the EIR Act 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.”

- 22 CPNZ and CPW are involved, and wish to remain involved, in both electricity lines and electricity supply businesses. CPNZ and CPW have, in terms of section 17 of the EIR Act, a prohibited cross-involvement.
- 23 CPNZ and CPW have, 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**

- 24 For the purpose of considering this application for exemption, 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 P R Rebstock and D Curtin.
- 25 The Commission's decision is based on an investigation conducted by its staff and their subsequent advice to the Commission.

### **Criteria Used by the Commission to Consider Exemption Applications**

- 26 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<sup>1</sup>.
- 27 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 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 Act. That is, the purpose of the EIR Act 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.”

- 28 The Commission noted in Practice Note No.3 that:

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<sup>1</sup> Practice Note No.3, September 1998, Electricity Industry Reform Act 1998 Commission's Role and Processes.

“...the EIR Act provides for maximum cross-ownership limits and specific structural and behavioural requirements to ensure that the purposes of the Act are met. Strict compliance with these limits and requirements is, other than in exceptional circumstances,<sup>(2)</sup> expected.”

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

“On receipt of an application in the proscribed form, 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 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?
- 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 market(s)<sup>3</sup> 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.”

## **EXAMINATION IN TERMS OF THE COMMISSION’S CRITERIA**

### **Incentives or Opportunities to Inhibit Competition in the Electricity Industry**

- 30 The Commission’s focus under this heading is on that part of the national electricity retail market comprising the electricity consumers who are tenants of CPNZ or CPW and whether an exemption would provide CPNZ or CPW with incentives or opportunities to inhibit competitive electricity supply to them.
- 31 The Commission considers that CPNZ and CPW could, in some circumstances, have the incentives and opportunities to inhibit competitive electricity supply to their tenants using the market power arising from their ownership of electricity lines.
- 32 However, the leasing of CPNZ and CPW’s properties occurs in a competitive property market. The Commission considers that such competition for tenants mitigates to some extent incentive or opportunity for CPNZ or CPW to attempt to raise electricity prices by anti-competitive behaviour.
- 33 The Commission will require as a condition to any exemption it grants that CPNZ and CPW shall not charge for the use of their electricity lines and shall permit reasonable access to those electricity lines by other electricity retailers. These conditions will also mitigate the opportunities for CPNZ and CPW to act anti-competitively.

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<sup>2</sup> For example, of the types provided for in section 19 of the EIR Act.

<sup>3</sup> Defined using the same process as used for market definitions in respect of Commerce Act matters.

- 34 Therefore, given these factors, the Commission considers that CPNZ and CPW's incentives and opportunities to inhibit competitive electricity supply to its tenants are no more than minimal and can be suitably dealt with by conditions attached to any exemption granted by the Commission.

**Incentives or Opportunities to Cross-subsidise Generation Activities**

- 35 Neither CPNZ nor CPW are involved in electricity generation activities. This criterion is not relevant.

**A Relationship Not at Arms Length**

- 36 CPNZ and CPW propose to continue to own and operate both electricity lines and electricity supply businesses. The two businesses will have common managers, premises and records. Managers will make decisions about both line and supply pricing and also about the terms for the granting of access to the two companies' lines by electricity retailers who wish to supply electricity to their tenants. The relationship between the electricity lines and supply businesses will not be at arms length.
- 37 However, the Commission considers that the potential effects of the relationship, not being at arms length, can be tempered by the fact that CPNZ and CPW do not charge for the line function services they supply to their tenants. CPNZ and CPW have undertaken that they will not introduce line charges for the use of their lines in the future. CPNZ and CPW are, in this respect, restricted in their ability to use the existence of a relationship not at arms length to defeat the purposes of the EIR Act. As a result, the Commission does not consider the potential effects of the relationship not being at arms length to be a material risk to the purposes of the EIR Act.

**THE COMMISSION'S DECISION**

- 38 Therefore, provided certain conditions are adhered to, the Commission considers that CPNZ and CPW's application satisfies the Commission's criteria for the granting of exemptions from the EIR Act.
- 39 The Commission exempts CPNZ and CPW from the application of section 17 of the EIR Act subject to the terms and conditions specified in the Notice of Exemption. This exemption is valid for all future property investments made by CPNZ.
- 40 The Commission also notes that section 81(5) provides that the Commission may vary or revoke any exemption at any time.



## NOTICE OF EXEMPTION

The Commission, pursuant to section 81 of the Electricity Industry Reform Act 1998, exempts Capital Properties New Zealand Limited and its subsidiary Capital Properties (Wellington) Limited, from the application of section 17 of that Act in relation to prohibited cross-involvements in an electricity lines business and an electricity supply business.

The exemption is subject to the following terms and conditions:

- (a) Neither CPNZ nor CPW will charge any tenant for the use of or related to, any electricity lines business owned or operated by CPNZ or CPW;
- (b) CPNZ and CPW will allow access to electricity lines owned by them or in their control, on reasonable terms and within a reasonable time, to any electricity supply business to enable such electricity supply business to supply electricity to any tenant of CPNZ or CPW connected to such lines;
- (c) Neither CPNZ nor CPW will enforce any obligation, in any lease or other agreement with their tenants, that requires a tenant to obtain electricity from or through CPNZ or CPW to enable any tenant to obtain electricity from or through any electricity supplier;
- (d) CPNZ and CPW will use their best endeavours to provide such reasonable information that any tenant being supplied electricity by either CPNZ or CPW may request, to enable that tenant to assess competitive options available to it for the supply of electricity; and
- (e) Neither CPNZ nor CPW generates, or is interested in the generation of, electricity.

In addition, the Commission, pursuant to section 81 of the EIR Act, exempts from the applications of sections 17, 18 and 30 of the EIR Act any business or involvement or interest in relation only to any future property investment and management activities that CPNZ and CPW might undertake, and in respect of which sections 17, 18 and/or 30 would apply.

The exemption to any business or involvement or interest in respect of any future property investment and management activities that CPNZ or CPW might undertake is given subject to the following terms and conditions being fully observed by the business or involvement or interest to which the exemption applies:

- (a) The terms and conditions as set out above in relation to the exemption given to the cross-involved entities; and
- (b) That CPNZ and/or CPW informs the Commission of the details of any future property investment and/or management activity, within 20 working days (as that term is defined in the Commerce Act 1986) from the day following the day it undertakes the activity, that is likely to breach the EIR Act and for which CPNZ, CPW and/or any other persons are likely to rely on this exemption.

The Commission may vary or revoke this exemption in accordance with section 81(5) of the EIR Act.

The exemption takes effect from the date of publication of this Notice in the Gazette.

Dated this 13<sup>th</sup> day of March 2002

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Paula Rebstock  
Deputy Chair