



COMMERCE COMMISSION

Decision No. 629

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

LLOYD MORRISON

The Commission:

D R Bates
D F Curtin

Summary of the Application:

Application by Lloyd Morrison for exemption from s 17 of the EIR Act in respect of certain prohibited cross-involvements that would result from appointment to the position of director of Auckland International Airport Limited.

Determination:

The Commission, pursuant to s 81 of the EIR Act, determines to grant an exemption from compliance with s 17 on the conditions specified in the Notice of Exemption.

Date of Determination:

19 November 2007

Date of Exemption:

This exemption takes effect upon publication in the New Zealand *Gazette*.

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EXECUTIVE SUMMARY

Introduction

- 1 On 15 October 2007, the Commerce Commission (the Commission) registered an application (the Application) from Lloyd Morrison for exemption from s 17 of the Electricity Industry Reform Act 1998 (the EIR Act).
- 2 Lloyd Morrison is currently a director of Wellington International Airport Limited (WIAL) and TrustPower Limited (TrustPower), both electricity supply businesses.
- 3 Lloyd Morrison has been nominated for the position of director of Auckland International Airport Limited (AIAL), an electricity lines business.
- 4 Lloyd Morrison is applying, under s 81 of the EIR Act, for exemption from the requirement to comply with s 17 of the EIR Act to allow his appointment to the position of director of AIAL, if his nomination is successful.

The Commission's Criteria

- 5 In considering an exemption from the EIR Act, the Commission has regard to the purposes of the Act and the extent to which granting the exemption would promote or inhibit these purposes.
- 6 To do this the Commission obtains and evaluates objective answers to the following 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?

Incentives or Opportunities to Inhibit Competition in the Electricity Industry

- 7 The Commission is of the view that, in respect of the national electricity generation and wholesaling market, the electricity retailing market, and the regional electricity distribution market corresponding to AIAL's network, the granting of an exemption in this case, subject to certain conditions, would not create incentives or opportunities to inhibit competition.

Incentives or Opportunities to Cross-Subsidise Electricity Generation Activities From Electricity Line Business Involvements

- 8 The Commission considers that, in this case, the granting of an exemption from s 17 of the EIR Act, subject to certain conditions, would not create incentives or opportunities to cross subsidise between lines activities and generation activities.

Creation of a Relationship not at Arms Length

- 9 The Commission considers that as the exemption is unlikely to create incentives or opportunities to inhibit competition in the electricity industry or to cross-subsidise generation activities from electricity lines businesses, an exemption from the requirement

to comply with rules s 17 in this case, subject to certain conditions, is unlikely to have any material adverse effect.

Determination

- 10 The Commission determines to grant an exemption to Lloyd Morrison from s 17 of the EIR Act, in respect of the cross-involvements outlined in the Application, subject to the following terms and conditions:
 - whilst Lloyd Morrison is cross-involved with TrustPower Limited and Auckland International Airport Limited, Lloyd Morrison shall not participate in any discussions or decision making by TrustPower Limited and/or Auckland International Airport Limited regarding matters that relate to or could affect or favour the supply of electricity by TrustPower Limited (or disadvantage any other electricity supply business other than TrustPower Limited) on Auckland International Airport Limited's electricity distribution network or the provision of electricity lines services by Auckland International Airport Limited to TrustPower Limited, including:
 - a. the selection of, and any negotiation with, any electricity retailer for the supply, or intended supply, of electricity to Auckland International Airport Limited; and
 - b. the supply, or intended supply, of electricity by TrustPower Limited to any new, or existing, consumers on Auckland International Airport Limited's electricity distribution network;and shall not disclose the outcomes of any discussions or decision making by Auckland International Airport Limited to TrustPower Limited (and vice versa) on those matters; and
 - this exemption is specific to the cross-involvements created through Lloyd Morrison's involvement in Auckland International Airport Limited. It does not extend to any other interest or existing or future cross-involvement of Lloyd Morrison.
- 11 The exemption takes effect from the date of its publication in the *New Zealand Gazette*.

INTRODUCTION

- 1 On 15 October 2007, the Commerce Commission (the Commission) registered an application (the Application) from Lloyd Morrison for exemption from s 17 of the Electricity Industry Reform Act 1998 (the EIR Act).
- 2 Lloyd Morrison's involvements in electricity businesses arise from his being a director of both Wellington International Airport Limited (WIAL) and TrustPower Limited (TrustPower), and his potential appointment to the position of director of Auckland International Airport Limited (AIAL).
- 3 Lloyd Morrison is applying, under s 81 of the EIR Act, for exemption from the requirement to comply with s 17 in respect of the cross-involvements that would arise from his appointment to the position of director of AIAL.

COMMISSION PROCEDURES

General

- 4 For the purpose of considering this application for exemption, the Commission, in terms of s 73 of the Crown Entities Act 2004, has delegated its powers under s 81 of the EIR Act to D R Bates and D F Curtin, Commission members.

Criteria Used by the Commission to Consider Exemption Applications

- 5 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.3.¹
- 6 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.

¹ Commerce Commission, *Practice Note No.3: Electricity Industry Reform Act 1998 Commission's Role and Processes*, September 1998.

7 Practice Note No.3 states that:

On receipt of an application in the prescribed 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 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:

- The relevant market(s)² 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.

- 8 In the particular circumstances of this case, the Commission decided to invite submissions on the Application. The Commission received one submission in support of the Application, from Meridian Energy Limited.

PARTIES

The Applicant

Lloyd Morrison

- 9 Lloyd Morrison (the Applicant) is an Infratil Limited (Infratil) appointed director of WIAL and TrustPower.
- 10 Lloyd Morrison was also nominated for the position of director of AIAL by Infratil and the New Zealand Superannuation Fund (NZ Super Fund) on 10 October 2007. His nomination will be voted on at AIAL's annual general meeting on 20 November 2007.
- 11 Infratil is a specialist investor in infrastructure and utility assets. The company is listed on the New Zealand Stock Exchange (NZX) and owns airports in New Zealand and Europe as well as energy and other investments in New Zealand and Australia. Infratil is the major shareholder in WIAL and TrustPower. Infratil and NZ Super Fund have a 6.2% shareholding in AIAL.

Other Parties

Auckland International Airport Limited

- 12 AIAL owns and operates the Auckland Airport. AIAL is a public company listed on the NZX and Australian Stock Exchange (ASX). It has a very diverse shareholding base. The largest shareholders are the Auckland and Manakau City Councils.

² Defined using the same market definition process as applied in Commerce Act matters. See also Commerce Commission, *Mergers and Acquisitions Guidelines*, 1 January 2004.

- 13 AIAL owns the electricity distribution network at the airport. The network operates at 11,000 and 400 volts and comprises transformers, switchgear and underground cables. The network connects to Vector Limited's citywide network at the perimeter of the airport. AIAL is a lines customer of Vector Limited.
- 14 AIAL distributes electricity to 366 consumers at the airport. Of the 90 GWh per annum distributed over AIAL's network, 29 GWh is for AIAL's own use. AIAL levies a line charge for the provision of its line function services.
- 15 Electricity retailers TrustPower, Genesis Power Limited, Contact Energy Limited and Mighty River Power Limited each have access to AIAL's network in accordance with Use of System Agreements in order that they may retail electricity to consumers connected to AIAL's network.

Wellington International Airport Limited

- 16 WIAL owns and operates Wellington International Airport. WIAL is 66% owned by Infratil through New Zealand Airports Limited, and 34% owned by Wellington City Council.
- 17 WIAL owns all the electrical wiring in the main terminal building (MTB) of Wellington International Airport from the points of connection with the local distribution network operated by Vector Limited to WIAL's own electrical installations and to the premises of its tenants. It conveys electricity over these lines to its tenants and itself at a voltage of 400V.
- 18 WIAL purchases all the electricity for use in the MTB from Contact Energy Limited and both uses this electricity itself and on-sells some to its tenants. It pays Contact Energy for both the electricity supplied by Contact Energy and the electricity line function services provided by Vector.
- 19 WIAL conveyed over its electricity lines, and sold, approximately 2.7GWh per annum of electricity to its tenants in the period 1 November 2005 to 31 October 2006. In this period, WIAL conveyed approximately 5.8GWh of electricity over its lines for its own use, making a total of 8.5GWh per annum.
- 20 [

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TrustPower

- 21 TrustPower is an electricity generator and retailer. It is the fourth largest electricity retailer in New Zealand. TrustPower owns 34 hydro power stations and the Tararua Wind Farm. TrustPower sells financial hedges to other retail market participants and to large industrial consumers. All TrustPower's generation is based on renewable resources. TrustPower retails approximately 4,300GWh of electricity per annum to around 220,000 consumers. TrustPower's primary retail bases are outside the main metropolitan areas of Auckland, Wellington and Christchurch. TrustPower sells electricity to six AIAL tenants, namely:

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- 22 TrustPower is listed on the NZX. There are currently three large shareholders in TrustPower. The largest shareholder is Infratil, which currently owns approximately 50.5% of the shares in TrustPower.

LLOYD MORRISON'S APPLICATION

- 23 Lloyd Morrison has been nominated for the position of director of AIAL (which owns the electricity distribution network at Auckland International Airport). Lloyd Morrison is also a director of TrustPower (which generates and retails electricity) and WIAL (which conveys and sells electricity).
- 24 Lloyd Morrison has applied, under s 81 of the EIR Act, for exemption from the requirement to comply with s 17 in respect of the cross-involvement that would arise from his appointment to the position of director of AIAL.

APPLICATION OF THE EIR ACT

Electricity Lines Business Involvements

- 25 The definition of "electricity lines business" appears in s 4(1) of the EIR Act. That provides as follows:

4. Meaning of 'electricity lines business'

- (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.

- 26 There are a number of exceptions to this definition in subsection (2):

- (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;
 - (b) Conveying electricity solely for its own consumption or for the consumption of its associates;
 - (c) Conveying electricity only from a generator to the national grid or from the national grid to a generator;
 - (d) Conveying electricity (other than via the national grid) only from a generator to a local distribution network or from a local distribution network to a generator;
 - (e) Conveying electricity by lines that are owned or operated by a business that also owns or operates a generator which generates electricity solely for the consumption of a local community, where both those lines and that generator are not connected, directly or indirectly, to the national grid;
 - (f) Conveying electricity only by a line or lines that are mostly in competition with a line or lines operated by another electricity lines business that is not an associate of the person, provided that the competition is actual competition and not potential competition;
 - (g) Owning or operating, directly or indirectly, lines referred to in any of paragraphs (a) to (f) or any other core assets of an electricity lines business used in connection with those lines.

- 27 In terms of the EIR Act, AIAL:

- conveys electricity by line in New Zealand (s 4(1)(a));

- owns and operates, directly, lines in New Zealand and other core assets of an electricity lines business(s 4(1)(b)); and
- does not fall within any of the exclusions listed in s (4)(2).

28 Therefore, AIAL is an electricity lines business in terms of the EIR Act.

29 In terms of the EIR Act, WIAL:

- conveys electricity by line in New Zealand (s 4(1)(a));
- owns and operates, directly, lines in New Zealand and other core assets of an electricity lines business(s 4(1)(b)); and
- does not fall within any of the exclusions listed in s (4)(2).

30 Therefore, WIAL is also an electricity lines business in terms of the EIR Act. However, the electricity lines business aspect of WIAL is not relevant for the purposes of the cross-involvements outlined in the Application and for which the Applicant seeks an exemption in respect of his cross-involvement that would arise from Lloyd Morrison's appointment as a director of AIAL, and so is not considered further.³

Electricity Supply Business Involvements

31 The EIR Act provides for the definition of "electricity supply business" in s 5(1):

5. Meaning of 'electricity supply business'

(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; and
- (c) Includes the ownership or operation, directly or indirectly, of any core assets of an electricity retail business, which include –
 - (i) The customer data base 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.

32 Subsection (2) provides for a number of exemptions from s 5(1):

- (2) None of the following activities brings a person within subsection (1):
 - (a) Selling or generating less than 2.5 GWh per annum;
 - (b) Generating or selling electricity solely for its own consumption or for the consumption of its associates;
 - (c) Generating electricity solely for the consumption of a local community, where -
 - (i) The generator is owned or operated by a business that also conveys electricity by line; and

³ Note, the Applicant, together with Infratil, has also applied for an exemption relating to his involvement in WIAL in a separate application received on 24 September 2007. WIAL's status as an electricity lines business is relevant to that matter. The Commission is continuing to consider that application, and the potential cross-involvements due to WIAL's status as an electricity lines business will be discussed there.

- (ii) Both those lines and that generator are not connected, directly or indirectly, to the national grid:
- (d) Selling electricity that is generated at a generator referred to in paragraph (c) or subsection (3):
- (e) Generating electricity from distributed generation, and selling the electricity generated, where –
 - (i) the generating capacity of the distributed generation is no more, at any one time, than the greater of 5 MW (determined according to nameplate or nameplates) and 2% of the maximum demand, in the immediately preceding financial year, of the lines to which the distributed generation is connected; and
 - (ii) the distributed generation is owned or operated by a business that also conveys electricity by line and that distributed generation is connected to those lines:
- (f) Selling financial transmission rights that hedge risks arising from the effects of losses and constraints on the national grid:
- (g) Owning or operating, directly or indirectly, a generator referred to in any of paragraphs (b) to (f) or subsection (3) or any other core generation assets used in connection with those generators.

33 In terms of the EIR Act, WIAL:

- sells electricity in New Zealand (s 5(1)(a)(i));
- owns and operates directly core assets of an electricity retail business (s 5(1)(c)(i)) which includes the benefit of contracts to sell electricity (s 5(1)(c)(ii)); and
- does not fall within any of the exclusions listed in ss 5(2) or 5(3).

34 Therefore, WIAL is an electricity supply business in terms of the EIR Act. [

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35 In terms of the EIR Act, TrustPower:

- sells electricity in New Zealand (s 5(1)(a)(i));
- sells financial hedges for risks relating to the price of electricity in New Zealand (s 5(1)(a)(ii));
- generates electricity in New Zealand (s 5(1)(a)(iii));
- owns and operates directly generators in New Zealand (s 5(1)(b));
- owns and operates directly core assets of an electricity retail business (s 5(1)(c)(i)), which includes the benefit of contracts to sell electricity (s 5(1)(c)(ii)); and
- does not fall within any of the exclusions listed in ss 5(2) or 5(3).

36 Therefore, TrustPower is also an electricity supply business in terms of the EIR Act.

Cross-Ownership Prohibition

37 One of the key intentions of the EIR Act on its inception was to effect ownership separation between electricity supply and electricity lines businesses, as they are defined by the EIR Act. Accordingly, s 17 of the EIR Act expressly prohibits such cross-ownership. It provides:

17. Cross-ownership prohibition

- (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.

The Meaning of Cross Involvement

38 Section 7(1) of the EIR Act defines “involved”:

7. Meaning of ‘involved’

- (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 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; -
- and ‘involvement’ has a corresponding meaning.

39 Section 11 of the EIR Act defines “material influence”:

- (1) Without limiting the ordinary meaning of the expression “material influence”, the following people are deemed to have material influence over an electricity business:
- (a) A manager of a person that carries on the business:
 - (b) If the business is carried on by a natural person, that person:
 - (c) A person in accordance with whose directions, instructions, or wishes a person referred to in either of paragraph (a) or paragraph (b), or the business, may be required or is accustomed to act in respect of the carrying on or management of the business:
 - (d) A person that exercises or that is entitled to exercise, or who controls or is entitled to control the exercise of, powers which would ordinarily fall to be exercised by a person referred to in either of paragraph (a) or paragraph (b):
 - (e) A person that can appoint or remove, or control the appointment or removal of, a person referred to in either of paragraph (a) or paragraph (b):
 - (f) A person that has a power to influence a decision of the business which would ordinarily require the holding of control rights which would cause the person to exceed the 10% threshold:
 - (g) A person in circumstances where that person and the business is acting, or proposing to act, jointly or in concert in relation to the business; or
 - (h) A person that, under a trust or agreement (whether or not the person is a party to it), may at any time have any of the powers referred to in paragraph (c) to paragraph (f).
- (2) Where a person has material influence over an electricity business under this section, and another person has any of the powers or controls referred to in paragraph (c) to paragraph (h) in relation to the first person or the majority of its managers, then that other person is deemed also to have material influence over the business, and so on.
- (3) A person is deemed to have material influence over an electricity business if the person is one of 2 or more associates who, together, have material influence over the business.
- (4) Subsection (3) does not apply to deem a person to have material influence over a business only because that person is, under section 12(1)(b) or (c), an associate of another person, provided those associates act in accordance with the arms length rules (with all necessary modifications) in respect of the business.
- (5) For the avoidance of doubt, a power to cast one of many votes at an election of trustees or councillors does not, of itself, constitute material influence.

40 Lloyd Morrison’s appointment to the position of director of AIAL would cause him to be involved in an electricity lines business as well as two electricity supply businesses. In terms of the EIR Act:

- AIAL, WIAL and TrustPower are all body corporates. Lloyd Morrison is a “manager” of WIAL and TrustPower and, if appointed to the position of director of AIAL, would also be a “manager” of AIAL (s 3);

- without limiting the ordinary meaning of the expression “material influence”, a manager of a person that carries on an electricity business is deemed to have material influence over the electricity business (s 11(1)(a)); and
- a person is involved in an electricity business if the person has material influence over the business (s 7(1)(c)).

41 Therefore, on his appointment to the position of director of AIAL, Lloyd Morrison, as a result of his directorships of TrustPower and WIAL, would be involved in both an electricity lines business and two electricity supply businesses.

The Commission’s Exemption Power

42 Section 81(1) of the EIR Act provides the Commission with a power of exemption:

- (1) The Commission may, for the purposes of this Act, in its discretion and upon the terms and conditions (if any) that it thinks fit, by notice in the *Gazette*, exempt—
 - (a) any business, involvement, or interest, or class of business, involvement, or interest, from the application of this Act; or
 - (b) any person or class of persons from compliance with any provisions of this Act or any regulations made under it.

LLOYD MORRISON’S SUBMISSIONS IN SUPPORT OF HIS APPLICATION FOR EXEMPTION

43 The Applicant submitted that the material risk to the purposes of the EIR Act in granting the exemptions is either nil or minimal.

44 In respect of the cross-involvement between AIAL and WIAL, the Applicant submitted that:

- the exemption sought would have no, or a very minimal, impact on the incentives or opportunities to inhibit competition in the electricity industry because WIAL operates an electricity supply business in respect only of the tenants of Wellington International Airport and has no plans or intentions to expand beyond that area into the Auckland region. In addition, [];
- the exemption sought will not have any impact on the incentives or opportunities to cross-subsidise generation activities; and
- the exemption sought will have no, or minimal, effect on permitting a relationship that is not at arms’ length.

45 In respect of the cross-involvement between AIAL and TrustPower, the Applicant submitted that:

- the exemption sought would have a minimal impact on the incentives or opportunities to inhibit competition in the electricity industry because:
 - i) while TrustPower has a Use of System Agreement with AIAL, TrustPower supplies electricity only to AIAL’s tenants, not to AIAL itself. Accordingly there is no current supply relationship between the businesses of AIAL and TrustPower;
 - ii) []

];

- iii) there are three other retailers who also supply electricity to AIAL's tenants, so TrustPower's opportunities to act in an anti-competitive way are limited;
 - iv) the Applicant's ability to act, as a director of AIAL, in a way that could favour TrustPower or influence the way that AIAL deals with TrustPower, is very limited because the Applicant will be only one director on the AIAL Board and Infratil has only a small shareholding in AIAL, and the Applicant is unable to vote on any matter in which he is considered "interested", which would include matters relating to TrustPower;
 - v) the proposed amendments to the EIR Act, if passed, would relax the prohibitions on cross-directorships such that the Applicant's directorships in AIAL, TrustPower and WIAL would not be in breach of the EIR Act, and the sought exemptions would not be required. While the amendments will not be made before the Commission reaches a decision on the Application, the Minister of Energy and Ministry officials' noted that the reasoning for relaxing the prohibition on cross-directorships is to lower the costs of corporate separation and compliance and that any risk of anti-competitive behaviour is mitigated by the Securities Markets Act 1988 (in the case of listed companies) and the remaining arms length rules; and
 - vi) to the extent that competition would be inhibited, this would be outweighed by the consequences for the Applicant, Infratil, the NZ Super Fund if the exemption was not granted.
- the exemption sought would have very limited impact on the incentives or opportunities to cross-subsidise generation activities because, in addition to the reasons set out above, the closest generation assets owned by TrustPower to Auckland Airport are in the Bay of Plenty and are, therefore, significantly geographically separated from AIAL's electricity network. The Applicant notes that the potential for cross-subsidisation is of particular concern to the Commission where a generator has the potential to connect generation to a local distribution network; and
 - the exemption sought would confer little, if any, ability to create a relationship between AIAL and TrustPower that is not at arms length because, in addition to the reasons set out above, both AIAL and TrustPower have provisions in their constitutions or are bound by rules by virtue of the NXZ Listing Rules that prevent interested directors from voting on a matter related to an interested transaction except in limited circumstances. In relation to the Applicant, these provisions would apply to a transaction involving both AIAL and TrustPower.

EXAMINATION IN TERMS OF THE COMMISSION'S CRITERIA

Relevant Markets

46 The Commission is of the view that the relevant markets⁴ in this instance are the national electricity generation and wholesaling market⁵, the relevant electricity retailing markets⁶

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

and the electricity distribution market that corresponds with AIAL's electricity distribution network⁷.

Question 1: 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 inhibit competition in the electricity industry?

National Electricity Generation and Wholesaling Market

- 47 In respect of the cross-involvement between AIAL and WIAL, neither AIAL nor WIAL participate in the national electricity generation and wholesaling market. Therefore, the granting of an exemption would not, in respect of this cross-involvement, create incentives or opportunities to inhibit competition in the national generation and wholesaling market.
- 48 In respect of the cross-involvement between AIAL and TrustPower, TrustPower's generation assets are not directly connected to AIAL's distribution network, nor is it intended that they will be in the future. TrustPower's generation assets are hydro and wind-farm generators which are not directly connected to AIAL's distribution network. Therefore, the granting of an exemption would not, in respect of this cross-involvement, create incentives or opportunities to inhibit competition in the national electricity generation and wholesaling market.

Electricity Retailing Markets

- 49 In respect of the cross-involvement between AIAL and WIAL, WIAL only sells electricity to consumers connected to its own network. WIAL does not currently, and does not intend, to sell to consumers on AIAL's network. As there is no retail market which AIAL and WIAL have in common, the granting of an exemption would not, in respect of this cross-involvement, create incentives or opportunities to inhibit competition in the electricity retailing market.
- 50 In respect of the cross-involvement between AIAL and TrustPower, the focus of the Commission's enquiry is on AIAL's network, that is, on the retail electricity market comprising the 366 consumers connected to AIAL's distribution network at Auckland International Airport, and whether an exemption would provide either TrustPower or AIAL with incentives or opportunities to inhibit competition in that market.
- 51 In Decision 517 (Dr Keith Turner)⁸, the Commission considered that, in the absence of any existing or future connection or relationship between Meridian and AIAL, other than that due to the presence of Dr Turner's position as Chief Executive of Meridian and his presence on AIAL's Board, there was no mechanism at that time whereby Dr Turner's

⁵ For a discussion of electricity generation market definition see Commerce Commission, *Decision 340: Transalta Corporation of Canada / Contact Energy*, 12 February 1999 and Commerce Commission, *Decision 491: Contact Energy Limited / Natural Gas Corporation Holdings Limited*, 04 February 2003.

⁶ For a discussion of relevant electricity retailing markets definition see Commerce Commission, *Decision 517: Dr Keith Turner*, 17 March 2004 and Commerce Commission, *Decision 547: Mr Wayne Boyd*, 31 March 2005.

⁷ For discussion of electricity distribution market definition see Commerce Commission, *Decision 345: United Networks Limited / Transalta New Zealand Limited*, 11 March 1999 and Commerce Commission, *Decision 299: Holdco (Mercury Energy Ltd and Utilicorp) / Power New Zealand Ltd*, 27 June 1997.

⁸ Commerce Commission, *Decision 517: Dr Keith Turner*, 17 March 2004

cross-involvements could provide incentives or opportunities to inhibit competition in electricity markets.

- 52 In this case, unlike Decision 517, there is an existing connection or relationship between TrustPower and AIAL, other than that due to Lloyd Morrison's directorship of TrustPower and his presence on AIAL's Board, as TrustPower supplies electricity to consumers connected to AIAL's network. The Commission considers mechanisms may exist presently whereby Lloyd Morrison's cross-involvements could provide incentives or opportunities to inhibit competition in electricity retail markets.
- 53 Whilst the Commission accepted in Decision 517 that Dr Turner could not vote on matters on which he had declared a conflict of interest, it considered that there would be the opportunity for competition to be inhibited by means other than by the formal voting process. Accordingly, the Commission considered it appropriate in Dr Turner's case (and also in Decisions 384 (Ms Joan Withers)⁹ and 547 (Mr Wayne Boyd)¹⁰) to prohibit Meridian Energy from supplying electricity to customers connected to AIAL's network. At the time each of these decisions were made, Meridian was not supplying electricity to any consumers on AIAL's network.
- 54 In this case, TrustPower is already supplying electricity to six consumers on AIAL's network and, while the Commission accepts that the Applicant could not vote on matters on which he had declared a conflict of interest, it considers that there would be the opportunity for competition to be inhibited by means other than by the formal voting process.
- 55 The Commission considers it is not appropriate to prohibit TrustPower from supplying electricity to consumers connected to AIAL's network because:
- there already exists a relationship between TrustPower and AIAL that was formed prior to Lloyd Morrison's cross-involvement which introduced the potential to create opportunities for competition to be affected;
 - while there is the possibility that another retailer may enter this market in the future, there are currently only four retailers supplying electricity to consumers on AIAL's network. Prohibiting TrustPower from supplying electricity to consumers connected to AIAL's network would reduce the choice of retailers available to consumers on AIAL's network;
 - Lloyd Morrison's influence on either TrustPower or AIAL outside of the voting process could be more directly addressed by prohibiting Lloyd Morrison's involvement (or perceived involvement) in matters that relate to or could affect or favour the supply of electricity by TrustPower (or disadvantage any other electricity supply business other than TrustPower) on AIAL's electricity distribution network or the provision of electricity lines services by AIAL to TrustPower; and
 - the incentives or opportunities to inhibit competition in the electricity industry would be mitigated by the provisions in the constitutions of AIAL and TrustPower, and the NZX Listing Rules, as both AIAL and TrustPower are listed companies.
- 56 In the present circumstances, the Commission considers that the opportunities for competition to be affected that is created by Lloyd Morrison's directorship of an electricity lines business and two electricity supply businesses can be effectively

⁹ Commerce Commission, *Decision 384: Ms Joan Withers*, March 2000

¹⁰ Commerce Commission, *Decision 547: Mr Wayne Boyd*, 31 March 2005

addressed by limiting Lloyd Morrison's participation in matters that relate to electricity supply or electricity lines services between those companies, or between one of those companies and another electricity business. Therefore, the Commission considers that any exemption granted should be subject to the condition that the Applicant be prohibited from participating in any discussions or decision making that relates to or could affect or favour the supply of electricity by TrustPower (or disadvantage any other electricity supply business other than TrustPower) on AIAL's electricity distribution network or the provision of electricity lines services by AIAL to TrustPower.

Regional Electricity Distribution Markets

- 57 The regional electricity distribution market that is relevant to the Application is the electricity distribution market that corresponds with AIAL's electricity distribution network.
- 58 Local electricity distribution networks are characterised by being local natural monopolies. The granting of this exemption would not affect the level or existing competition or scope for potential competition within those markets.
- 59 Accordingly, the granting of an exemption would not, in respect of this market, create incentives or opportunities to inhibit competition.

Conclusion on Question 1

- 60 The Commission is of the view that, in respect of the national electricity generation and wholesaling market, the relevant electricity retailing markets, and the regional electricity distribution market corresponding to AIAL's network, the granting of an exemption in this case, subject to certain conditions, is unlikely to create incentives or opportunities to inhibit competition.

Question 2: Incentives or Opportunities to Cross-subsidise Generation Activities

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?

- 61 The cross-involvement between AIAL and TrustPower is relevant to this question, as TrustPower is an electricity generation business.
- 62 The Commission considers that a lines business which is also engaged in generation has the opportunity to cross-subsidise its generation business, should it choose to do so. Cross-subsidisation could take a number of forms. It may be that the lines business would meet costs which more properly lie with the generation side of the business. It may be that common costs would all be attributed to the lines business. It may be that the lines business would provide capital to the generation business at less than its true cost. It may be that the generation project would be funded in a way which weakens the financial stability of the lines business.
- 63 Any of these possibilities of cross-subsidisation could increase upward pressure on lines charges.
- 64 The Commission considers that the potential for cross-subsidisation is of particular concern where a generator has the potential to connect generation to a local distribution network. However, no connection of TrustPower's generating assets to AIAL's distribution network is proposed in this case.

- 65 In Decision 517 (Dr Keith Turner), the Commission considered that there existed a potential mechanism by which AIAL's electricity lines business could be used to subsidise Meridian's generation activities. This could occur via a use-of system agreement negotiated between Meridian and AIAL, which did not provide a commercial return to AIAL, and the opportunity for the negotiation of such an agreement could be influenced by the presence of Dr Turner as a person having material influence in the two companies.
- 66 In this case, a use-of-system agreement already exists between TrustPower and AIAL, which was entered into prior to Lloyd Morrison's cross-involvement. [

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- 67 The Commission considers that, providing the Applicant does not participate in any future discussions or decision making that relates to or could affect or favour the supply of electricity by TrustPower (or disadvantage any other electricity supply business other than TrustPower) on AIAL's electricity distribution network or the provision of electricity lines services by AIAL to TrustPower, AIAL would have no incentives or opportunities to cross-subsidise TrustPower's generation activities from its lines business.

Conclusion on Question 2

- 68 The Commission considers that, in this case, the granting of an exemption from s 17 of the EIR Act, subject to certain conditions, is unlikely to create incentives or opportunities to cross subsidise between lines activities and generation activities.

Question 3: A Relationship Not at Arms Length

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?

- 69 In most circumstances where an exemption is required from the ownership separation provisions of the EIR Act, a relationship will be created that will ultimately not be at arms length. In each case the Commission assesses the practical effect of the non-arms length relationship in order to decide whether that relationship is likely to lead to a result that would be contrary to the purposes of the EIR Act.
- 70 Lloyd Morrison proposes to become a director of AIAL (an electricity lines business) and continue as director of WIAL and TrustPower (both electricity supply businesses). On the face of it, a relationship will be created between an electricity lines business and two electricity supply businesses that will not be at arms length.
- 71 Previously, the Commission has determined that where the granting of an exemption would not create incentives or opportunities to inhibit competition in the electricity industry or would not create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses then the arms length requirement may have no practical effect.
- 72 The Commission also considers that any potential effects of the relationship not being at arms length can be tempered by the condition that the Applicant would not participate in any discussions or decision making that relates to or could affect or favour the supply of electricity by TrustPower (or disadvantage any other electricity supply business other

than TrustPower) on AIAL's electricity distribution network or the provision of electricity lines services by AIAL to TrustPower.

- 73 In this case, the Commission considers granting an exemption from s 17, subject to certain conditions, in respect of Lloyd Morrison's cross-involvement that would arise from his appointment as a director of AIAL would create a relationship not at arms length. The potential effects of this relationship would be unlikely to suborn the purposes of the EIR Act.

Conclusion on Question 3

- 74 The Commission considers that as the exemption is unlikely to create incentives or opportunities to inhibit competition in the electricity industry or to cross-subsidise generation activities from electricity lines businesses, an exemption from the requirement to comply with s 17 in this case, subject to certain conditions, is unlikely to have any material adverse effect.

Conclusion in Respect of the Commission's Criteria

- 75 The Commission considers that, provided that the Applicant does not participate in any discussions or decision making that relates to or could affect or favour the supply of electricity by TrustPower (or disadvantage any other electricity supply business other than TrustPower) on AIAL's electricity distribution network or the provision of electricity lines services by AIAL to TrustPower, the granting of an exemption in this case would not create incentives or opportunities to inhibit competition in the electricity industry and would not result in any material increase in the opportunities or incentives to cross subsidise generation activities from lines activities.
- 76 The Commission considers that the exemption would create a relationship between an electricity supply business and an electricity lines business that is other than at arms length but that that relationship, due to the above considerations, would have no material adverse effect.
- 77 Accordingly, the Commission determines to grant an exemption to Lloyd Morrison from s 17 of the EIR Act, in respect of the cross-involvements outlined in the Application, subject to the following terms and conditions:
- whilst Lloyd Morrison is cross-involved with TrustPower Limited and Auckland International Airport Limited, Lloyd Morrison shall not participate in any discussions or decision making by TrustPower Limited and/or Auckland International Airport Limited regarding matters that relate to or could affect or favour the supply of electricity by TrustPower Limited (or disadvantage any other electricity supply business other than TrustPower Limited) on Auckland International Airport Limited's electricity distribution network or the provision of electricity lines services by Auckland International Airport Limited to TrustPower Limited, including:
 - a. the selection of, and any negotiation with, any electricity retailer for the supply, or intended supply, of electricity to Auckland International Airport Limited; and
 - b. the supply, or intended supply, of electricity by TrustPower Limited to any new, or existing, consumers on Auckland International Airport Limited's electricity distribution network;

and shall not disclose the outcomes of any discussions or decision making by Auckland International Airport Limited to TrustPower Limited (and vice versa) on those matters; and

- this exemption is specific to the cross-involvements created through Lloyd Morrison's involvement in Auckland International Airport Limited. It does not extend to any other interest or existing or future cross-involvement of Lloyd Morrison.

78 The exemption takes effect from the date of its publication in the *New Zealand Gazette*.

THE COMMISSION'S DETERMINATION

79 The Commission determines to grant an exemption from section 17 of the EIR Act, subject to the terms and conditions stated in the Notice of Exemption.

Dated this 19th day of November 2007

Donal Curtin
Commissioner

NOTICE OF EXEMPTION

The Commerce Commission (Commission), pursuant to section 81 of the Electricity Industry Reform Act 1998 (the EIR Act), exempts Lloyd Morrison from compliance with section 17 of the EIR Act in respect of the cross-involvements (as that term is defined in the EIR Act) with Wellington International Airport Limited (for so long as Wellington International Airport Limited continues to be an electricity supply business) and TrustPower Limited that would be created through his appointment to the position of director of Auckland International Airport Limited outlined in his application for exemption registered by the Commission on 15 October 2007.

The exemption is subject to the following conditions:

1. whilst Lloyd Morrison is cross-involved with TrustPower Limited and Auckland International Airport Limited, Lloyd Morrison shall not participate in any discussions or decision making by TrustPower Limited and/or Auckland International Airport Limited regarding matters that relate to or could affect or favour the supply of electricity by TrustPower Limited (or disadvantage any other electricity supply business other than TrustPower Limited) on Auckland International Airport Limited's electricity distribution network or the provision of electricity lines services by Auckland International Airport Limited to TrustPower Limited, including:
 - a. the selection of, and any negotiation with, any electricity retailer for the supply, or intended supply, of electricity to Auckland International Airport Limited; and
 - b. the supply, or intended supply, of electricity by TrustPower Limited to any new, or existing, consumers on Auckland International Airport Limited's electricity distribution network;

and shall not disclose the outcomes of any discussions or decision making by Auckland International Airport Limited to TrustPower Limited (and vice versa) on those matters; and
2. this exemption is specific to the cross-involvements created through Lloyd Morrison's involvement in Auckland International Airport Limited. It does not extend to any other interest or existing or future cross-involvement of Lloyd Morrison.

The exemption takes effect from the date of publication of this notice in the *New Zealand Gazette*.

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

Dated this 19th day of November 2007

Donal Curtin
Commissioner