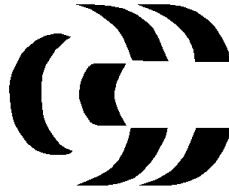


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## COMMERCE COMMISSION

### Decision No. 344

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:

#### **CARTER HOLT HARVEY LTD**

**The Commission:**

K M Brown  
E C A Harrison  
P R Rebstock

**Commission Staff:**

D R Ainsworth  
V E Healy  
K Smith  
A J Brice

**Summary of  
Application:**

Carter Holt Harvey 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 EIR Act.

**Determination:**

The Commission, pursuant to section 81 of the EIR Act, exempts Carter Holt Harvey Ltd from the application of section 17 of the EIR Act in relation to a prohibited cross-involvement in an electricity lines business and an electricity supply business. The exemption is subject to the conditions stated in this Decision.

**Date of Determination:**

15 March 1999

**Date of Exemption:**

**On publication of the Notice of Exemption in the *Gazette***

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## CONTENTS

<b>INTRODUCTION .....</b>	<b>3</b>
<b>CARTER HOLT HARVEY LTD .....</b>	<b>3</b>
CHH'S ELECTRICITY SUPPLY BUSINESS.....	3
CHH LINES BUSINESS .....	4
<b>INVOLVEMENTS .....</b>	<b>4</b>
ELECTRICITY LINES BUSINESS.....	4
ELECTRICITY SUPPLY BUSINESS.....	5
<b>PROHIBITED CROSS-INVOLVEMENT.....</b>	<b>5</b>
<b>COMMISSION PROCEDURES.....</b>	<b>6</b>
GENERAL.....	6
CRITERIA USED BY THE COMMISSION TO CONSIDER EXEMPTION APPLICATIONS .....	6
<b>RELEVANT MARKET .....</b>	<b>7</b>
<b>CHH'S ARGUMENTS.....</b>	<b>7</b>
<b>EXAMINATION IN TERMS OF THE COMMISSION'S CRITERIA.....</b>	<b>8</b>
INCENTIVES OR OPPORTUNITIES TO INHIBIT COMPETITION IN THE ELECTRICITY INDUSTRY .....	8
INCENTIVES OR OPPORTUNITIES TO CROSS-SUBSIDISE GENERATION ACTIVITIES.....	10
A RELATIONSHIP NOT AT ARMS LENGTH .....	10
<b>THE COMMISSION'S DECISION.....</b>	<b>10</b>
<b>NOTICE OF EXEMPTION .....</b>	<b>11</b>

## INTRODUCTION

- 1 The Commerce Commission (the Commission) has received an application from Carter Holt Harvey Ltd for exemption from the application of the EIR Act. The application was received on 15 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.

## CARTER HOLT HARVEY LTD

- 3 Carter Holt Harvey Ltd (CHH) is a large, multinational, company involved in forestry ownership, wood products, pulp and paper, tissues and packaging. The United States based International Paper Inc holds a controlling interest with the remaining shares widely dispersed among corporate investors and small private shareholders. CHH's operating revenue in 1998 was over \$3 billion.
- 4 CHH's mill at Penrose in South Auckland manufactures corrugated paper packaging. CHH's mill at Kinleith, near Tokoroa, is a pulp and paper production plant. Both mills have extensive electricity distribution networks which provide electricity supply to the many electrically operated machines which comprise the two facilities.
- 5 CHH has other plants throughout New Zealand which have electricity distribution networks but these are not relevant to this application.
- 6 The total electricity consumption of CHH's New Zealand operations is approximately 1,000 gigawatt-hours per annum. CHH also purchases electricity from the wholesale electricity market and arranges its own electricity price hedge contracts.

## CHH's Electricity Supply Business

- 7 At both the Penrose and Kinleith mills, CHH supplies electricity to companies, not associated with CHH, which operate in the proximity of the two mills on CHH land, and which are suppliers of materials or services to each of the mills.
- 8 CHH's Penrose plant supplies approximately [ ] gigawatt-hours per annum of electricity to Paper Reclaim Ltd.<sup>1</sup>
- 9 CHH's Kinleith plant supplies approximately [ ] gigawatt-hours per annum of electricity, most importantly to Pedersen Holdings Ltd's wood chipping operation, Fernz Chemicals (NZ) Ltd's oxygen plant and Air Liquide Ltd's carbon dioxide plant, but also to other smaller consumers such as the vehicle repair garage and fuel dispensing station on its site. These consumers are supplied with electricity under ten year contracts with CHH.
- 10 CHH leases a 39 megawatt electricity generator from Kinleith Cogeneration Ltd.<sup>2</sup> The generator produces 280 gigawatt-hours per annum. The electricity requirement of the

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<sup>1</sup> Commission staff were informed that Air Liquide Ltd's operations at CHH Penrose, mentioned in paragraph 5.4.4 of CHH's application, have ceased.

Kinleith plant is 520 gigawatt-hours per annum, therefore, CHH is a net importer of electricity from Transpower Ltd's national grid.

### **CHH Lines Business**

- 11 At the Penrose mill, CHH owns and operates the 11,000 volt and 400 volt electricity distribution networks on its site and conveys electricity by line, mostly for its own use. However CHH also conveys approximately [ ] gigawatt-hours per annum electricity to Paper Reclaim Ltd at its adjacent site on CHH land at Penrose.
- 12 At the Kinleith mill, UnitedNetworks Ltd (UNL) owns and operates the 11,000 volt network on the site.<sup>3</sup> CHH owns the majority of the 400 volt network on the site,<sup>4</sup> which conveys approximately 520 gigawatt-hours per annum.
- 13 CHH does not own or operate the 400 volt lines supplying Pedersen Holdings, Fernz Corporation, Air Liquide and also the other smaller consumers. Such 400 volt lines bypass CHH's network, are connected directly to UNL's network at the mill, and are owned and operated by the consumers themselves.
- 14 However, CHH does convey approximately [ ] gigawatt-hours per annum of electricity to the Kinleith site automotive and plant repair garage and fuel dispensing operation (the Garage). The Garage consists of several small businesses not associated with CHH, but which previously were part of CHH's operations. When CHH decided to sell the Garage businesses to its employees working in the area, the sale did not include the 400 volt electricity line supplying the Garage.
- 15 Thus, despite its ownership and operation of a large lines business at Kinleith, it is only in relation to the Garage that it supplies electricity to companies not associated with it, by use of lines which it owns and operates.

## **INVOLVEMENTS**

### **Electricity Lines Business**

- 16 CHH is the owner of a 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 excluded from the definition of an electricity lines business by section 4(2).
    - CHH conveys a very large quantity of electricity at its Kinleith, Penrose and other plants in New Zealand, far above 2.5 gigawatt-hours per annum (section 4(2)(a)). It does not convey electricity solely for its own use (section

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<sup>2</sup> Wholly owned by ECNZ Ltd.

<sup>3</sup> Formerly Power New Zealand Ltd and the Thames Valley Electric Power Board (TVEPB). These parties' involvement in the electrical reticulation of the Kinleith Mill began at the time of the initial development of the Mill when, according to CHH staff, it was in the interests of both New Zealand Forest Products Ltd and TVEPB for the reticulation of the mill to be carried out by TVEPB.

<sup>4</sup> Which is connected to UNL's network via transformers owned by UNL.

4(2)(b)) because it conveys [ ] gigawatt-hours to Paper Reclaim Ltd at Penrose and [ ] gigawatt-hours to the Garage at Kinleith.

17 CHH:

- 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)).

18 Therefore CHH is involved in an electricity lines business in terms of the EIR Act. CHH agrees with this interpretation in its application for exemption.

### **Electricity Supply Business**

19 CHH in terms of the EIR Act:

- sells electricity in New Zealand (s5(1)(a)(i));
- owns and operates indirectly a generator in New Zealand;
- owns and operates directly core assets of an electricity retail business which include the benefit of contracts to sell electricity (s5(1)(c));
- is excluded from the definition of an electricity supply business in respect of its ownership and operation of a generator because it generates electricity solely for its own consumption (5(2)(b)); and
- has no other activities excluded from the definition of an electricity supply business by section 5(2);

20 CHH:

- 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)).

21 Therefore, CHH is also involved in an electricity supply business in terms of the EIR Act. CHH agrees with this interpretation in its application for exemption.

### **PROHIBITED CROSS-INVOLVEMENT**

22 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.”

23 CHH is involved, and wishes to remain involved, in both an electricity lines and an electricity supply business. CHH will, after 1 April 1999, in terms of section 17 of the EIR Act, have a prohibited cross-involvement.

- 24 CHH 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**

- 25 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, and P R Rebstock.
- 26 The Commission's decision is based on an investigation conducted by its staff and their subsequent advice to the Commission.
- 27 During their investigation into the application, Commission staff interviewed and obtained information from:
- CHH at Penrose, Kinleith and its Manukau City Head Office;
  - Petersen Holdings Ltd at Kinleith;
  - Paper Reclaim Ltd at Penrose;
  - TrustPower Ltd; and
  - First Electric Ltd.

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

- 28 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>5</sup>
- 29 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

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<sup>5</sup> Practice Note No.3, September 1998, Electricity Industry Reform Act 1998 Commission's Role and Processes.

- (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.”

30 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,<sup>(6)</sup> expected.”

31 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.”

## RELEVANT MARKET

- 32 The national electricity retail market is relevant to the application of the Commission’s criteria to the facts of CHH’s application for exemption.<sup>7</sup>

## CHH’S ARGUMENTS

- 33 CHH argues it is only “technically” involved in an electricity supply business and an electricity lines business for the purposes of the EIR Act, and the nature of CHH’s business is such that the purposes of the EIR Act will not be suborned.
- 34 CHH submits that the amount of electricity which CHH purchases to on-sell at its Penrose and Kinleith plants is very small in relation to its total consumption.<sup>8</sup>

<sup>6</sup> For example, of the types provided for in section 19 of the EIR Act.

<sup>7</sup> 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.

<sup>8</sup> 0.07% and 1.5% of total electricity consumption at Penrose and Kinleith respectively.

- 35 CHH notes that, given it is a wholesale electricity purchaser, and that, in devising its charges to those consumers to whom it supplies electricity, it passes on its lines and electricity purchase costs to those consumers at average cost (at Kinleith) and with a [ ]% administration margin (at Penrose), CHH provides these consumers with very attractive electricity prices.
- 36 CHH argues that this results in charges for delivered electricity of [ ] cents per kilowatt-hour at Penrose and [ ] cents per kilowatt-hour at Kinleith. Commission staff have confirmed this fact with TrustPower Ltd, an electricity retailer operating in the two [ ] regions [ ]].
- 37 CHH also notes that there are escalation provisions in the contracts which CHH has with the electricity consumers it supplies for their supply to CHH of goods and services. One of the escalators is the price of electricity. CHH therefore, argues that if it increases the price of electricity to the consumers it supplies, this will result in increased costs to itself. CHH states that the reason for it supplying electricity to these consumers in the first place was to ensure its suppliers of goods and services had the lowest possible cost bases.
- 38 CHH notes that, in the event the Commission declines its exemption application, it would be forced to extract itself from its contracts for the provision of electricity at considerable inconvenience and cost to itself. It argues that given the favourable deal its electricity consumers currently receive, that inconvenience and expense would be for no gain.

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

### **Incentives Or Opportunities To Inhibit Competition in the Electricity Industry**

<p>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?</p>
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- 39 Given the absence of competition issues in electricity generation markets and local distribution markets arising from CHH's application for exemption, the focus of the following analysis is on that part of the national electricity retail market comprising the consumers at the two relevant CHH plants and whether an exemption would provide CHH with incentives or opportunities to inhibit competitive electricity supply to them.
- 40 The Commission notes CHH's argument that it has a "technical" involvement in electricity lines and supply businesses. However, the EIR Act defines the activities of an electricity lines business and an electricity supply business. Where CHH's activities fall within these definitions, the EIR Act will apply, regardless of whether electricity lines and electricity supply are a major or minor part of CHH's business.
- 41 The Commission considers that CHH has had, and continues to have, incentives to provide electricity at low prices to the relevant customers. These incentives would not be changed by the granting of an exemption.

- 42 CHH would have an opportunity to alter the balance of its pricing between supply of distribution services and supply of electricity. However, its incentive to adopt such an approach is minimal. Any overall increase in price would be passed back to itself, while any attempt to raise line prices and offer low electricity supply prices would expose itself to the risk of losing the customer to another electricity retailer. If CHH attempted to prevent another retailer from supplying by not entering into a use-of-systems agreement for the relevant line, CHH would be at risk under both the Commerce Act and the EIR Act.
- 43 In respect of other 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. 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.
- 44 CHH has a cross-involvement because of the particular set of circumstances:
- the amount of electricity it conveys to consumers other than itself is small ([ ] gigawatt-hours per annum). If that were CHH's only lines business it would be excluded from the application of the definition of an electricity lines business by section 4(2)(a) of the EIR Act. However, CHH conveys a large amount of electricity, by lines it owns and operates, for its own consumption and this takes it outside the exclusion criterion; and
  - the amount of electricity CHH supplies to consumers over lines which it owns and operates is small (again [ ] gigawatt-hours per annum). If that were CHH's only supply business it would be excluded from the definition of an electricity supply business by section 5(2)(a) of the EIR Act. However, CHH also supplies an additional [ ] gigawatt-hours per annum to other consumers, though not over lines it owns and operates.<sup>9</sup> In this respect it acts as an ordinary retailer of electricity trading in the competitive national electricity retail market.
- 45 Thus, in respect of opportunities to inhibit competitive electricity supply, CHH has market power resulting from its ownership and operation of an electricity lines business only in respect of [ ] gigawatt-hours per annum. The Commission considers that this is well within the 2.5 gigawatt-hour per annum exclusion from the application of the EIR Act provided by section 4(2)(a). Therefore, the Commission considers that CHH's incentives and opportunities to inhibit competitive electricity supply are no more than minimal.

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<sup>9</sup> As discussed the lines are owned by UNL and the consumers concerned.

### *Conclusion On Incentives Or Opportunities To Inhibit Competition*

- 46 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 not provide CHH with incentives or opportunities to inhibit competition in the national electricity retail market.

### **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?

- 47 For the purposes of the EIR Act, Parliament has decided that generating electricity solely for a person's own consumption or the consumption of its associates should be disregarded.<sup>10</sup>
- 48 CHH consumes approximately 1,000 gigawatt-hours per annum and generates about 280 gigawatt-hours per annum. It appears all electricity generated by CHH is for its own consumption. Therefore, this criterion is not relevant to the Commission's decision.

### **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?

- 49 CHH 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 CHH's network by electricity retailers who wish to compete with CHH's electricity supply business. The relationship between CHH's electricity lines and supply businesses will not be at arms length.
- 50 However the Commission considers that the potential effects of the relationship not being at arms length can only be applied to the approximately [ ] gigawatt-hours per annum of electricity conveyed and supplied by CHH. The Commission does not consider these potential effects of the relationship not being at arms length to be material and considers that they will not suborn the purposes of the EIR Act.

### **THE COMMISSION'S DECISION**

- 51 CHH's application passes two of the three criteria used by the Commission to decide upon exemptions from the EIR Act. The third criterion is not applicable.
- 52 In making its decision the Commission notes that the facts revealed in CHH's application are particular to its situation alone. The Commission also notes that section 81(5) provides that the Commission may vary or revoke any exemption at any time.

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<sup>10</sup> Section 5(2)(b).

53 Therefore, having considered the stated criteria, the Commission exempts CHH from the application of section 17 of the EIR Act, subject to the terms and conditions specified in the Notice of Exemption.

### **NOTICE OF EXEMPTION**

The Commission, pursuant to section 81, exempts Carter Holt Harvey Ltd from the application of section 17 of the Electricity Industry Reform Act 1998 in relation to a prohibited cross-involvement in an electricity lines business, being the installed electricity distribution networks at the Penrose and Kinleith mills, and an electricity supply business.

The exemption is subject to the following terms and conditions:

- (a) That if Carter Holt Harvey Ltd commences supplying electricity to other than the following electricity consumers or their assigns it notifies the Commission:
- Alkeiman Industries Ltd;
  - C Pepper Ltd;
  - D Ryan Ltd;
  - Kinleith Tractor Shop Ltd;
  - Mike Lambert Ltd;
  - Fernz Chemicals (NZ) Ltd;
  - Pedersen Holdings Ltd;
  - Air Liquide (NZ) Ltd and
  - Paper Reclaim Ltd
- (b) That if Carter Holt Harvey Limited provides electricity line services to other than the following electricity consumers of their assigns it notifies the Commission:
- Kinleith Tractor Shop Ltd;
  - Mike Lambert Ltd; and
  - Paper Reclaim Ltd.
- (c) That Carter Holt Harvey Limited remains a net importer of electricity from Transpower Ltd's national grid.
- (d) That Carter Holt Harvey Limited advises the Commission of any increases in the electricity price it charges the above consumers.

Where any change of the type referred to in (a) to (d) occurs, 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 15<sup>th</sup> day of March 1999

The Commission