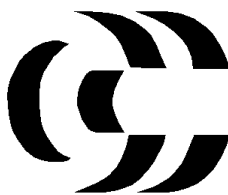


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## COMMERCE COMMISSION

### Decision No. 348

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

#### **AUCKLAND INTERNATIONAL AIRPORT LTD**

**The Commission:**

K M Brown  
E C A Harrison  
P R Rebstock

**Commission Staff:**

D R Ainsworth  
K Smith  
A J Brice

**Summary of  
Application:**

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

**Determination:**

The Commission, pursuant to section 81 of the EIR Act, exempts Auckland International Airport Ltd from the application 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:**

26 March 1999

**Date of Exemption:**

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

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## **INTRODUCTION**

- 1 On 13 March 1999 the Commerce Commission (the Commission) received an application from Auckland International Airport Ltd for exemption from the application of the EIR Act until [ ].
- 2 The Commission's powers to exempt businesses, involvements or interests from the application of the EIR Act or persons from compliance with any provisions of any regulations made under the EIR Act are specified in section 81 of the EIR Act.

## **AUCKLAND INTERNATIONAL AIRPORT LTD**

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

## **AIAL's Electricity Lines Business**

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

9 [

]

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

### **AIAL's Electricity Supply Business**

11 AIAL also retails electricity. AIAL has negotiated an electricity purchase contract with TrustPower. It on-sells the electricity it purchases under that contract to all but two of the consumers<sup>1</sup> connected to its network at the Airport. AIAL [ ] TrustPower charges it, to establish the electricity prices which Airport electricity consumers pay.

12 AIAL retails about [ ] GWh of electricity per annum to [ ] consumers at the airport.

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

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

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

### **AIAL's Electricity Generation Equipment**

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

### **Sale of AIAL's Electricity Supply Business**

17 On 5 March 1999, the Commission declined to grant a previous application by AIAL for exemption from the provisions of the EIR Act so that it could retain ownership of both its electricity lines and supply businesses.

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<sup>1</sup>[ ]

- 18 AIAL intends to sell its electricity supply business in order to comply with the ownership separation provisions of the EIR Act.
- 19 The sale process AIAL intends to adopt is:
- prepare and issue an information memorandum to potential purchasers;
  - request tenders;
  - negotiate a sale and purchase agreement with tenderers;
  - enter into a sale and purchase agreement; and
  - settle the transaction.
- 20 The information memorandum was issued to potential purchasers on 12 March 1999.

## **INVOLVEMENTS**

### **Electricity Lines Business**

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

### **Electricity Supply Business**

- 24 AIAL in terms of the EIR Act:
- sells electricity in New Zealand (s5(1)(a)(i));
  - owns and operates directly a generator in New Zealand;
  - owns and operates directly core assets of an electricity retail business which include a customer data base relating to and used for the purposes of an electricity retail or electricity trading business and the benefit of contracts to sell electricity (s5(1)(c));
  - has no activities exempted by section 5(2); and
  - is exempted by section 5(3) in respect of its generation activities.
- 25 AIAL:
- carries on an electricity supply business alone or together with associates (s7(1)(a));

- exceeds the 10% threshold in terms of control rights and equity return rights in that business (s7(1)(b)); and
- has material influence over that business (s7(1)(c)).

26 Therefore, AIAL is also currently involved in an electricity supply business in terms of the EIR Act. AIAL agrees with this interpretation.

## **PROHIBITED CROSS-INVOLVEMENT**

27 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.”

28 Until AIAL sells its electricity supply business it is involved in both an electricity lines and an electricity supply business and after 1 April 1999 will have a prohibited cross-involvement, in terms of section 17 of the EIR Act.

29 AIAL believes, that in order to maximise the value of its electricity supply business, it requires [ ] months to complete the sale process subsequent to the issue of its information memorandum.

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

## **COMMISSION PROCEDURES**

### **General**

31 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.

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

33 During their investigation into the application, Commission staff obtained information from:

- AIAL;
- TrustPower;
- Electricity Corporation of New Zealand ; and
- Contact Energy Ltd (Contact).

## Criteria Used by the Commission to Consider Exemption Applications

34 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>2</sup>

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

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

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

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

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

36 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>(3)</sup> expected.”

37 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:

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

<sup>3</sup> For example, of the types provided for in section 19 of the EIR Act.

- 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 MARKETS

38 The national electricity retail market is relevant to the application of the Commission’s criteria to the facts of AIAL’s application for exemption.<sup>4</sup>

## AIAL’S ARGUMENTS

39 AIAL states it wishes to prevent [ ]  
 ].

40 AIAL believes that [ ]  
 ]

41 AIAL believes that there will be no adverse impact on the consumers it supplies with electricity if it continues to own and operate its electricity supply business for a limited period of time.

42 AIAL states that it had a [ ]  
 ]. It was for that reason it did not commence the sale process early enough for it to be completed by 1 April 1999.

43 AIAL argues that although a continuing cross-involvement may result in the detriments to its electricity consumers identified in Decision 338, a sale without haste would provide increased value to the large number of shareholders of AIAL and this would balance those detriments.

44 Finally AIAL believes that there may be a need to rearrange the electrical meters of the consumers it currently supplies as a result of the sale process, and potential difficulty with such a change may result in delays.

## EXAMINATION IN TERMS OF THE COMMISSION’S CRITERIA

45 In Decision 338 the Commission declined AIAL’s application for exemption, concluding that granting an exemption from the application of the EIR act to AIAL would:

- provide AIAL with incentives or opportunities to inhibit competition in the national electricity retail market; and
- result in a relationship between an electricity lines and supply business which was not at arms length.

<sup>4</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.

- 46 The new factor in the present application is that the time period of the prohibited cross-involvement would be closely circumscribed rather than open-ended.
- 47 Commission staff have determined that many of the sale and purchase transactions of the electricity supply business of electricity companies have taken place within two months of the issuing of an information memorandum by vendors. A number of these transactions have involved electricity supply businesses which were many times larger than that of AIAL, and, in a number of instances, have also included generation businesses. All industry sources spoken to by Commission staff stated that the sale and purchase of electricity supply businesses had become routine. Potential purchasers were able to deal with short time frames.
- 48 Contact informed Commission staff that, in its view, there was nothing in the process of the sale of its shares by the Government which would prevent it tendering for AIAL's electricity supply business. In its view AIAL's electricity supply business is a small potential acquisition which would not be material to Contact's share sale process.
- 49 AIAL's proposed sale of its electricity supply business appears standard with no considerations having been identified that would indicate that a longer time-frame would be required. Therefore, the Commission considers that AIAL can reasonably achieve the sale of its electricity supply business within a period of two months from the date of issue of AIAL's information memorandum on 12 March 1999, that is by 12 May 1999.
- 50 The Commission considers that such a six week exemption, from 1 April until 12 May, will not abrogate the purposes of the EIR Act. The Commission considers the effects arising from the incentives or opportunities to inhibit competition and the relationship between an electricity lines and supply business which is not at arms length, will be no more than minimal over such a period.

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

- 51 Therefore, having considered the stated criteria, the Commission exempts AIAL from the application of section 17 of the EIR Act until 12 May 1999, subject to the terms and conditions set out in the Notice of Exemption.

## **NOTICE OF EXEMPTION**

The Commission, pursuant to section 81, exempts Auckland International Airport 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 and an electricity supply business, being the electricity distribution network at Auckland International Airport and the supply of electricity to consumers connected to that network.

The exemption is subject to the following terms and conditions:

- (a) The exemption applies until 5pm on 12 May 1999 after which time it expires.
- (b) That Auckland International Airport Ltd advises the Commission of the name of the purchaser and the date of settlement of any sale and purchase agreement it negotiates with a purchaser of its electricity supply business immediately on entering such an agreement.
- (c) That Auckland International Airport Ltd shall be in full compliance with section 17 of the EIR Act on expiration of this exemption.

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

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

Dated this 26<sup>th</sup> day of March 1999

The Commission