



## COMMERCE COMMISSION

### Decision No. 675

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 and electricity generation and retail from the application of the EIR Act. The application is made by:

#### **HRL MORRISON & CO GROUP LIMITED**

- The Commission:** M N Berry  
P J M Taylor
- Summary of Application:** Application by HRL Morrison & Co Group Ltd for exemption from section 17 of the EIR Act in respect of certain prohibited cross-involvements between the sale of electricity by TrustPower on Auckland International Airport's (AIAL's) network and AIAL's lines.
- Determination:** The Commission, pursuant to section 81 of the EIR Act, determines to grant an exemption from compliance with section 17 on the conditions specified in the Notice of Exemption.
- Date of Determination:** 26 June 2009
- Date of Exemption:** This exemption takes effect upon publication in the New Zealand *Gazette*.

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## **EXECUTIVE SUMMARY**

### **Introduction**

1. On 4 September 2008, the Commerce Commission (the Commission) registered an application (the Application) from HRL Morrison & Co Group Ltd (HRL Morrison) for exemption from section 17 of the Electricity Industry Reform Act 1998 (the EIR Act).
2. On 20 February 2009, HRL Morrison submitted to the Commission a revised version of its Application, to take into account the passage of the Electricity Industry Reform Amendment Act 2008, which came into effect on 14 October 2008.
3. HRL Morrison's involvements in electricity businesses arise from its interests in Auckland International Airport Limited (AIAL) (electricity lines) and TrustPower Limited (TrustPower) (electricity generation and retail).
4. HRL Morrison is applying, under section 81 of the EIR Act, for exemption from the requirement to comply with section 17 in respect of these possible cross involvements.

### **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 3 and 5 of the EIR Act:
  1. 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?
  2. Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to cross-subsidise generation or retail activities from electricity lines activities?
  3. Where applicable, would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between a business that has involvement in electricity lines and a business that has involvement in electricity generation and retail, where those relationships may not otherwise be at arm's 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 wholesale market, the relevant electricity retail market, and the local 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.

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

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

*Requirement for Corporate Separation and Compliance with Arm's Length Rules*

9. The Commission considers that, as the Applicant is not a connected electricity businesses, there is no requirement for corporate separation or compliance with the Arm's Length Rules.

**Determination**

10. The Commission determines to grant an exemption to HRL Morrison and Co Group Limited from section 17 of the EIR Act, in respect of the cross-involvements outlined in the Application, subject to the following terms and conditions:
  1. neither HRL Morrison & Co Group Limited nor any of its interconnected bodies corporate shall hold a relevant interest (as defined in section 9(2) of the EIR Act) in [ ] of the control rights (as defined in section 9 of the EIR Act) or [ ] of the equity return rights (as defined in section 10 of the EIR Act) in Auckland International Airport Limited;
  2. whilst HRL Morrison and Co Group Limited is cross-involved with TrustPower Limited and Auckland International Airport Limited, neither HRL Morrison and Co Group Limited nor any of its subsidiaries shall 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 business selling electricity on Auckland International Airport Limited's network 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, 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
  3. this exemption is specific to the cross-involvements created through HRL Morrison & Co Group Limited's involvements in Auckland International Airport Limited and TrustPower Limited. It does not extend to any other interest or existing or future cross-involvement of HRL Morrison & Co Group Limited.

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

## **INTRODUCTION**

12. On 4 September 2008, the Commerce Commission (the Commission) registered an application (the Application) from HRL Morrison & Co Group Ltd (HRL Morrison) for an exemption from section 17 of the Electricity Industry Reform Act 1998 (the EIR Act).
13. On 20 February 2009, HRL Morrison submitted to the Commission a revised version of its Application, to take into account the passage of the Electricity Industry Reform Amendment Act 2008, which came into effect on 14 October 2008.
14. HRL Morrison's involvements in electricity businesses arise from its interests in Auckland International Airport Limited (AIAL) (electricity lines) and TrustPower Limited (TrustPower) (electricity generation and retail).
15. HRL Morrison is applying, under section 81 of the EIR Act, for exemption from the requirement to comply with section 17 in respect of these possible cross involvements.

## **COMMISSION PROCEDURES**

### **General**

16. For the purposes of considering this application for exemption, the Commission, in terms of section 73 of the Crown Entities Act 2004, has delegated its powers under section 81 of the EIR Act to M N Berry and P J M Taylor, Commission members.

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

17. The EIR Act was amended in October 2008 by the Electricity Industry Reform Amendment Act 2008.
18. The EIR Act gives the Commission wide powers of enforcement, extension and exemption.
19. 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 3 and 5 of the EIR Act as defined in sections 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 and electricity generation and retail that may create incentives or opportunities:
    - (i) to inhibit competition in the electricity industry; or
    - (ii) to cross-subsidise generation or retail activities from electricity lines activities; and
  - (b) where applicable, would not result in relationships between a business that has involvement in electricity lines and a business that has involvement in electricity generation or retail, where those relationships may not otherwise be at arm's length.

20. In determining exemption applications, 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:
- (a) that costs and prices in the electricity industry are subject to sustained downward pressure; and
  - (b) that the benefits of efficient electricity pricing flow through to all classes of consumers; and
  - (c) new investment in generation from renewable energy sources
- by –
- (d) effectively separating electricity lines from generation and retail where those activities are co-located; and
  - (e) promoting effective competition in electricity generation and retail; and
  - (f) limiting barriers to new investment in generation from renewable energy sources.
21. 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 3 and 5 of the EIR Act or the overall purpose of the EIR Act.
22. The Commission's test necessitates obtaining and evaluating objective answers to the following questions in relation to the particular purpose of Parts 1 to 3 and 5 of the EIR Act:
- 1. 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?
  - 2. Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to cross-subsidise generation or retail activities from electricity lines activities?
  - 3. Where applicable, would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between a business that has involvement in electricity lines and a business that has involvement in electricity generation and retail, where those relationships may not otherwise be at arm's length?
23. In relation to these questions, the Commission will consider such factors as:
- 1. The relevant market(s)<sup>1</sup> within the electricity industry;
  - 2. The nature of any incentives or opportunities created;
  - 3. The temporal nature of any incentives or opportunities created;
  - 4. The nature of any relationship that is not at arm's length; and
  - 5. The temporal nature of any relationship that is not at arm's length.

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

24. In the particular circumstances of this case, the Commission decided to invite submissions on the Application. The Commission received no submissions on this Application.

## **PARTIES**

### **The Applicant**

#### *HRL Morrison & Co Group Limited (HRL Morrison)*

25. HRL Morrison is, itself and through wholly-owned subsidiaries, a specialist investment bank, asset manager, fund manager and energy adviser, and consultant.
26. The Applicant's wholly owned subsidiaries include Morrison and Co Funds Management Limited (MCFM) and Morrison and Co Infrastructure Management Limited (MCIM).

#### *Morrison and Co Funds Management Limited (MCFM)*

27. MCFM is a wholly-owned subsidiary of the Applicant. MCFM is a manager (on a non-exclusive basis) for the Guardians of New Zealand Superannuation Fund (NZ Super Fund) investments in infrastructure assets.
28. This arrangement is set out in a management agreement between NZ Super Fund and MCFM (the NZSF Management Agreement). The NZSF Management Agreement provides that MCFM has all the powers and discretions in managing and investing NZ Super Fund's infrastructure portfolio that a natural person would have. MCFM is required to invest in accordance with the principles noted in paragraph 37 below. MCFM does not exercise voting rights in AIAL shares on behalf of NZ Super Fund<sup>2</sup>. [ ]
29. The NZ Super Fund had total funds in excess of \$14.7 billion as at 31 May 2008. The initial amount MCFM has been appointed to invest under the NZSF Management Agreement is [ ]. MCFM has made investments on NZ Super Fund's behalf in a number of companies. Of relevance to this application is that, as at 4 September 2008, MCFM purchased and managed for NZ Super Fund 6.936% of the shares in AIAL. MCFM manages these shares on NZ Super Fund's behalf. Note that, in total, NZ Super Fund holds 9.75% of the shares in AIAL, but some of these shares are not managed by MCFM and are, therefore, not relevant to the Applicant's involvements.
30. [ ]
31. MCFM also manages 0.2% of the shares in TrustPower on NZ Super Fund's behalf.

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<sup>2</sup> Under the Management Agreement between MCFM and NZ Super Fund, voting rights are reserved to NZ Super Fund. Under no circumstances would MCFM exercise voting rights on behalf of NZ Super Fund.

*Morrison and Co Infrastructure Management Limited (MCIM)*

32. MCIM is a wholly-owned subsidiary of the Applicant. MCIM is the manager (on an exclusive basis) of Infratil Limited (Infratil).
33. This arrangement is set out in a management agreement between Infratil and MCIM (the Infratil Management Agreement) under which MCIM is appointed as the sole and exclusive manager of Infratil unless otherwise agreed. MCIM's powers under the Infratil Management Agreement include the power to purchase, subscribe for, or otherwise acquire securities on behalf of or in the name of Infratil, and the power and authority to exercise on behalf of Infratil any right or power that Infratil has in the securities. This includes the right to vote at meetings.
34. As at 4 September 2008, MCIM purchased and managed for Infratil 50.5% of the shares in TrustPower. MCIM manages these shares on Infratil's behalf.
35. As at 4 September 2008, Infratil held 3.88% of the shares in AIAL. Infratil and MCIM agreed by letter on 22 August 2008 that the Infratil Management Agreement does not apply to shares or other control rights in AIAL held or acquired by Infratil from time to time. This ensured the Applicant, from the date of the letter, was not in breach of the EIR Act by reason of holding (through its wholly-owned subsidiaries) more than 10% of the control rights in both TrustPower and AIAL.
36. If the exemption sought in this application is granted, Infratil may consider, at some future date, whether to have its shares in AIAL again managed by MCIM under the Infratil Management Agreement.

**Other Parties**

*New Zealand Superannuation Fund (NZ Super Fund)*

37. The NZ Super Fund is a statutory body established by the New Zealand Superannuation Act 2001 (Superannuation Act) to manage and administer savings and investments on behalf of New Zealanders. The Superannuation Act requires the NZ Super Fund to invest on a prudent, commercial basis and, in doing so, must manage and administer its assets in a manner consistent with (among others):
  - (a) best practice portfolio management; and
  - (b) maximising return without undue risk.
38. The NZ Super Fund's investments in infrastructure assets are managed (on a non-exclusive basis) by MCFM.
39. The NZ Super Fund holds 9.75% of the shares in AIAL. 6.936% of the shares in AIAL that are held by the NZ Super Fund are managed by MCFM. The NZ Super Fund also holds 0.2% of the shares in TrustPower, although this is managed by an unrelated manager.

*Infratil Limited*

40. Infratil is a specialist investor in infrastructure and utility assets. Infratil is listed on the New Zealand Exchange (NZX) and owns airports in New Zealand and Europe as well as energy and other investments in New Zealand and Australia. Infratil holds 50.5% of the shares in TrustPower. Infratil also had, at 4 September 2008, a 3.88% shareholding in AIAL.

*Auckland International Airport Limited (AIAL)*

41. AIAL owns and operates the Auckland Airport. AIAL is a public company listed on NZX and Australian Stock Exchange (ASX). Apart from the NZ Super Fund, other large shareholders include the Auckland City Council (12.74%) and the Manukau City Council (10.04%).
42. AIAL has 6 directors. One director, Lloyd Morrison is a related party to the Applicant. As far as the Applicant is aware, all other directors are entirely independent of the Applicant, MCFM, MCIM, Infratil, TrustPower or any other party relevant to this application. AIAL's chairman is Tony Frankham and he is an "independent director" in terms of the NZX Listing Rules.
43. AIAL has its own senior management group headed by recently appointed chief executive, Simon Moutter. As far as the Applicant is aware, all of AIAL's senior management group are entirely independent of the Applicant, MCFM, MCIM, Infratil, TrustPower or any other party relevant to this application.
44. AIAL owns an 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.
45. AIAL distributes electricity to approximately 366 consumers at the Auckland International Airport. Of the approximately 90 gigawatt-hours (GWh) per annum distributed, 29 GWh is for AIAL's own use. AIAL levies a line charge for the provision of its line function services.
46. 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 (UoSA) in order that they may retail electricity to consumers connected to Auckland International Airport's network. AIAL is not itself a supplier of electricity either on its own network or any other. AIAL is supplied electricity by [ ].

*TrustPower Limited (TrustPower)*

47. TrustPower operates in the electricity generation and retail sectors in New Zealand. It is currently the fourth largest electricity retailer in New Zealand. TrustPower owns 34 hydro power stations and the Tararua Wind Farm. All TrustPower's generation is based on renewable resources. TrustPower retails approximately 4,300 GWh of electricity per annum to around 220,000 customers. TrustPower's primary retail bases are outside the main metropolitan areas of Auckland, Wellington and Christchurch.
48. TrustPower advises that, for the 12 month period ending 4 September 2008, it sold approximately [ ] of electricity to customers connected to AIAL's network. This equates to approximately [ ] of the total electricity distributed across AIAL's network. TrustPower does not sell electricity to AIAL.
49. TrustPower is listed on the NZX. There are currently two large shareholders in TrustPower. The largest shareholder is Infratil, which currently owns approximately 50.5% of the shares in TrustPower. The second largest shareholder is the Tauranga Energy Consumer Trust, whose beneficiaries are electricity consumers with a TrustPower account situated in Tauranga and the

Western Bay of Plenty. The NZ Super Fund holds 0.2% of the shares in TrustPower.

## **HRL MORRISON'S APPLICATION**

50. HRL Morrison has applied, under section 81 of the EIR Act, for exemption from the requirement to comply with section 17 in respect of the possible cross-involvement between the sale of electricity by TrustPower on AIAL's network, and AIAL's lines.
51. The exemption is sought to enable Infratil and MCIM, if they wished at a later date, to agree to the Infratil Management Agreement applying again to Infratil's shares or other control rights in AIAL, without the Applicant being in breach of the EIR Act. This would enable MCIM to manage the shares held by Infratil in AIAL and any additional shares acquired by Infratil in AIAL.
52. [ ]
53. The Applicant seeks the above exemption subject to the condition that the Applicant does not hold [ ]

## **APPLICATION OF THE EIR ACT**

### **Requirements of the EIR Act**

54. Section 17(2) of the EIR Act makes it a contravention of Part 2 of the Act for a person to breach the connected generation cap or connected customers selling cap.
55. The connected generation cap is not relevant to HRL Morrison's application because TrustPower does not have any generation connected to AIAL's network.
56. The connected customers selling cap is set out in section 17C of the EIR Act. Section 17C provides that the cap is breached if a person is involved in selling more electricity to connected customers within a local network area than the person's qualifying generation within that local network area. The person's qualifying generation is the sum of the total annual nominal MWh capacity of the generation listed in section 17C(2) of the EIR Act.
57. The term "sell" is defined in section 3 of the EIR Act to mean "any arrangement under which any electricity is brought and sold, except financial hedge contracts".
58. The term "connected customer" is defined in section 3 of the EIR Act to mean a consumer to whom a person sells electricity, if:
  - (a) the electricity is conveyed to that customer on a line in which the person is involved; and
  - (b) the consumer and the line are within the same network area.

59. Under section 7 of the EIR Act, as relevant to this application, “involved” means that a person is involved:
- (a) in a line if the person conveys electricity by the line, or owns or operates, directly or indirectly, the line or any other assets used in connection with the line, either alone or together with associates and either on its own or another’s behalf;
  - (b) in selling electricity to a customer if the person sells to a customer either on its own or another’s behalf;
  - (c) in either of the things referred to in the above subparagraphs, if the person:
    - (i) carries on a business that does any of those things, either alone or together with its associates and either on its own or another’s behalf; or
    - (ii) exceeds the 10% threshold in section 8 of the EIR Act in respect of a business that does any of those things; or
    - (iii) has material influence over a business that does any of those things.
60. The 10% threshold in section 8 of the EIR Act is defined to include holding more than 10% of the control rights in a business or holding more than 10% of the equity return rights in the business.
61. A control right is defined in section 9 of the EIR Act to mean a voting right attaching to a voting security. Under section 9(2) a person has a control right if the person would have a relevant interest, under sections 5 to 5B of the Securities Markets Act 1988, in the voting securities that confer that right.
62. An equity return right is defined in section 10 of the EIR Act to mean a right or entitlement or expectation to receive equity returns, directly or indirectly, of a business.
63. Section 19 of the EIR Act describes the businesses and involvements to be disregarded under the EIR Act. In particular:
- (a) section 19(1)(ge) of the EIR Act states that no account is to be taken of a person’s business, or involvement or interest in a business, if that person is involved in selling no more than 5 GWh of electricity to connected customers within a local network area, in total, in a financial year; and
  - (b) section 19(1A)(c) of the EIR Act states that no account is to be taken of a person’s involvement in a line that conveys less than 5 GWh per annum.

#### **Applicant’s involvements and possible involvements under the EIR Act**

64. In respect of the connected customers selling cap, TrustPower sells electricity as defined under section 3 of the EIR Act. The Applicant holds the following relevant interests in TrustPower:
- (a) a relevant interest in 50.5% of the shares in TrustPower by reason of it owning and controlling MCIM, which is the manager of the shares held by Infratil in TrustPower; and

(b) a relevant interest in 0.2% of the shares in TrustPower by reason of it owning and controlling MCFM, which is the manager of the shares held by the NZ Super Fund in TrustPower.

65. In accordance with section 9 of the EIR Act this means that the Applicant exceeds the 10% threshold in section 8 of that Act in respect of TrustPower, and is therefore “involved” in the sale of electricity by TrustPower under section 7 of the EIR Act.
66. This involvement is not disregarded under section 19(1)(ge) of the EIR Act because TrustPower, the business that the Applicant is involved in, sells approximately [ ] of electricity to connected customers within the AIAL electricity network. This is more than the 5 GWh per annum threshold at which no account is taken of a person’s involvement in a business.
67. As noted above, AIAL owns and operates the lines and other assets comprising the electricity network at Auckland International Airport. As at 4 September 2008, the Applicant had a relevant interest in 6.936% of the shares in AIAL by reason of the Applicant owning and controlling MCFM, which is the manager of these shares held by the NZ Super Fund in AIAL.
68. The Applicant does not have an interest in the 3.88% of the shares in AIAL held by Infratil, due to the agreement dated 22 August 2008 which excludes MCIM from managing these shares on behalf of Infratil.
69. Therefore, the Applicant does not have an involvement in the lines owned and operated by AIAL for the purposes of the definition of “connected customers” in section 3 of the EIR Act because that relevant interest is less than 10%.
70. [ ]
71. Further, Infratil may wish at a future date for the Infratil Management Agreement to apply to shares or other control rights in AIAL.
72. In accordance with sections 9 and 10 of the EIR Act, that might mean that the Applicant would exceed the 10% threshold in section 8 of that Act in respect of AIAL, and would, therefore, be “involved” in the lines owned and operated by AIAL for the purposes of the definition of “connected customers” in section 3 of the EIR Act.
73. This involvement would not be disregarded under section 19(1A)(c) of the EIR Act because AIAL conveys approximately 90 GWh of electricity, which is more than the 5 GWh per annum threshold at which no account is taken of a person’s involvement in a line.
74. Section 17D of the EIR Act states that the connected customers selling cap is breached by a person if the person is involved in selling more electricity to connected customers within a local network area, in total, in a financial year, than the equivalent of the person’s qualifying generation within the local network area.
75. The Applicant does not, and is not likely to, have any qualifying generation within AIAL’s local area network that it could offset against the sales of electricity on the AIAL network by TrustPower.

76. Accordingly, it is possible that the Applicant would breach the connected customers selling cap if its involvement in AIAL exceeded the 10% threshold. At that point section 17(2)(b) of the EIR Act would apply to the Applicant, in respect of its cross-involvement in AIAL's lines and TrustPower's selling of electricity. Consequently, the Applicant is seeking exemption from section 17 of the EIR Act in preparation for what may happen in the future.
77. As noted above, the connected generation cap is not relevant to this application. This is because the Applicant is not involved in any generation connected to AIAL's network.

## **HRL MORRISON'S SUBMISSIONS IN SUPPORT OF ITS APPLICATION**

78. The Applicant submitted that the material risk to the purposes of the EIR Act in granting the exemption is either nil or minimal.
79. The Applicant submitted that the exemption would have a minimal impact on the incentives or opportunities to inhibit competition in the electricity industry, and specifically in respect of the retail electricity market comprising the consumers connected to AIAL's distribution network because:
  - (a) the shareholdings in AIAL that the Applicant would be permitted to have control rights in would not give the Applicant the ability to influence electricity supply decisions in relation to AIAL's distribution network through share voting. This is because:
    - (i) control of a combined shareholding for Infratil and NZ Super Fund of [ ] or less would mean the Applicant would not have sufficient control or influence over AIAL to influence electricity supply decisions in relation to AIAL's distribution network or to control or determine the voting in shareholder meetings. The other large shareholders in AIAL (including Auckland City Council (12.75%) and the Manakau City Council (9.55%)) regularly vote at meetings, meaning that even a shareholding of [ ] would not give the Applicant control or influence;
    - (ii) decisions relating to AIAL's electricity supply are made by executives of AIAL, perhaps in some circumstances approved by AIAL's directors. In accordance with normal management principles, such decisions have not been, and never would be, made by the shareholders of AIAL. A shareholding of up to [ ] would not be sufficient to gain control of the Board of directors with an agenda to force management to make a specific decision on electricity supply;
    - (iii) in any event, MCFM does not exercise voting rights in AIAL shares on behalf of NZ Super Fund. [ ]; and
    - (iv) Infratil cannot hold control rights in AIAL in excess of 10% without an exemption under the EIR Act (which is not being made at this time). This is because of its cross ownership with TrustPower. It follows that MCIM (because Infratil is its only

client) is practically restricted to the same limit, even under the conditions proposed by the Applicant. For practical purposes, the Applicant would therefore only ever have voting control of up to 10% of AIAL's shares, being shares that are or may be acquired by Infratil. This is within the 10% control threshold in section 8 of the EIR Act.

- (b) the Applicant's ability to influence matters relating to the supply of electricity over AIAL's network through means other than share voting is very limited. The Applicant is several steps removed from any kind of operational decision and, in any case, a UoSA already exists between TrustPower and AIAL, on terms that are not materially more favourable than those of other retailers selling on AIAL's network; and
- (c) the Management Agreements in place prevent MCIM and MCFM respectively, and therefore the Applicant, from using management control over either Infratil's shares in AIAL (if these shares were subject to the Infratil Management Agreement) or NZ Super Fund's shares in AIAL (voting of which is subject to tight constraints) for the benefit of TrustPower.

## EXAMINATION IN TERMS OF THE COMMISSION'S CRITERIA

### Relevant Markets

80. The Commission is of the view that the relevant markets<sup>3</sup> in this instance are the national electricity generation and wholesale market<sup>4</sup>, the relevant electricity retail markets<sup>5</sup> and the electricity distribution market that corresponds with AIAL's electricity distribution network<sup>6</sup>.

### 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 Wholesale Market*

81. In respect of the possible cross-involvement between AIAL and TrustPower, TrustPower's generation assets are not directly connected to AIAL's distribution network, nor is it likely 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

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<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> For a discussion of relevant electricity retail markets definition see Commerce Commission, *Decision 517: Dr Keith Turner*, 17 March 2004 and Commerce Commission, *Decision 547: Mr Wayne Boyd*, 31 March 2005.

<sup>6</sup> 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.

not, in respect of this possible cross-involvement, create incentives or opportunities to inhibit competition in the national electricity generation and wholesale market.

*Electricity Retail Markets*

82. In respect of the possible 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.
83. The Applicant submits that an interest in [ ] of the shares in AIAL would not give the Applicant the ability to influence electricity supply decisions in relation to AIAL’s distribution network through share voting or by other means. In coming to a view on whether a person would be likely to be able to influence decisions in a business, the Commission considers each case on its particular facts. In this particular fact circumstance, the Commission considers that:

- (a) There are a number of directors in common to the relevant parties as set out below:

	HRL Morrison & Co Group Limited	MCFM	MCIM	NZ Super Fund	Infratil	AIAL	TrustPower
MORRISON, Hugh Richmond Lloyd	✓	✓	✓		✓	✓ <sup>7</sup>	✓ <sup>8</sup>
PETAGNA, Liberato	✓	✓	✓				
MCALISTER, Terence Kevin	✓	✓					
SAVILLE, Duncan Paul	✓				✓		
NEWMAN, David Arthur Ross				✓	✓		
BOGOIEVSKI, Marko					✓		✓ <sup>9</sup>
TUME, Mark				✓	✓		

- (b) the EIR Act sets a 10% threshold for holding an interest in an electricity business, above which, a person is considered to be involved

<sup>7</sup> Lloyd Morrison has taken a leave of absence from his directorship of AIAL, and has not been replaced.

<sup>8</sup> Lloyd Morrison has taken a leave of absence from his directorship of TrustPower, and has been replaced on an interim basis by Marko Bogoievski.

<sup>9</sup> Marko Bogoievski is a director on the Board of TrustPower on an interim basis, replacing Lloyd Morrison while he takes a leave of absence.

in that business and that holding a [ ] interest in a business would be [ ] the threshold for involvement set by the EIR Act; however;

- (c) the other large shareholders in AIAL include Auckland City Council (12.75%) and Manakau City Council (9.55%), with all other shareholders holding less than a 3% share in AIAL;
  - (d) the decisions relating to AIAL's electricity supply are made by executives of AIAL, although perhaps in some cases approved by AIAL's directors;
  - (e) MCFM does not exercise voting rights in AIAL shares on behalf of NZ Super Fund. [ ] The Infratil Management Agreement under which MCIM is appointed as the sole and exclusive manager of Infratil gives MCIM powers to purchase, subscribe for, or otherwise acquire securities on behalf of or in the name of Infratil, and the power and authority to exercise on behalf of Infratil any right or power that Infratil has in the securities. This includes the right to vote at meetings. However, MCIM and Infratil have agreed that the Infratil Management Agreement does not apply to shares or other control rights in AIAL held or acquired by Infratil from time to time; and
  - (f) The constitution of AIAL provides that Directors of AIAL may be elected by shareholders by an ordinary resolution (one fully paid share confers one vote) or by the Board and there may be no more than eight directors at any one time. Although HRL Morrison might hold up to [ ] of the shares in AIAL, this would not afford it the right to appoint directors to the Board. In addition, there are currently six Directors of AIAL, of which Lloyd Morrison is only one. The other Directors of AIAL are Tony Frankham (chair), Keith Turner, John Brabazon, Richard Didsbury and Joan Withers. The Applicant has advised that, aside from Lloyd Morrison, all other directors are entirely independent of the Applicant, MCFM, MCIM, Infratil, TrustPower or any other party relevant to this application.
84. In view of the facts of this case, the Commission considers an interest in [ ] of the shares in AIAL would be unlikely to give the Applicant the ability to influence electricity supply decisions in relation to AIAL's distribution network through share voting or by other means.
85. However, the Commission considers that a condition of any exemption should be imposed to restrict directors from having the ability to vote on any matters on which they have a conflict of interest with respect to the cross-involvements outlined in this Application, or take part in any such discussions.
86. In Decision 629 (Lloyd Morrison)<sup>10</sup> the Commission considered that there was an existing connection or relationship between TrustPower and AIAL, other than that due to Lloyd Morrison's directorship of TrustPower and his presences on AIAL's Board, as TrustPower was already supplying electricity to consumers connected to AIAL's network.
87. Similarly, in this case, TrustPower was already selling electricity to seven consumers on AIAL's network, prior to any cross-involvement of the Applicant. [ ] of the total electricity distributed across AIAL's network is sold by

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<sup>10</sup> Commerce Commission, *Decision 629: Lloyd Morrison*, 19 November 2007

TrustPower under an existing UoSA. The Applicant advises that this is on terms no more favourable than those of other retailers selling on AIAL's network.

88. As in Decision 629, the Commission considers it is not appropriate to prohibit TrustPower from supplying electricity to consumers connected to AIAL's network because:
1. there already exists a relationship between TrustPower and AIAL that was formed prior to the Applicant's cross-involvement which introduced the potential to create opportunities for competition to be affected;
  2. 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;
  3. cross-involved directors' influence on either TrustPower or AIAL outside of the voting process could be more directly addressed by prohibiting directors' 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
  4. 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.
89. In the present circumstances, the Commission considers that the opportunities for competition to be affected in the retail market that would be created by the Applicant's cross involvement in AIAL and TrustPower could be effectively addressed by limiting cross-involved directors' 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, or any cross-involved directors associated with 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.

#### *Electricity Distribution Markets*

90. The electricity distribution market that is relevant to the Application is the local electricity distribution market that corresponds with AIAL's electricity distribution network.
91. 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.

92. Accordingly, the granting of an exemption would not, in respect of this market, create incentives or opportunities to inhibit competition.

*Conclusion on Question 1*

93. The Commission is of the view that, in respect of the national electricity generation and wholesale market, the relevant electricity retail market, and the local 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 or Retail 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 or retail activities from electricity lines activities?
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94. The Commission considers that a lines business which is also engaged in generation or retail has the opportunity to cross-subsidise its generation or retail 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 or retail 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 or retail side of the business at less than its true cost. It may be that a generation or retail project would be funded in a way which weakens the financial stability of the lines business.
95. Any of the possibilities of cross-subsidisation could increase upward pressure, or dampen downwards pressure, on lines charges.
96. The Commission considers that the potential for cross-subsidisation of generation activities 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 and, therefore, there is no potential for cross-subsidisation of generation activities.
97. The Commission considers that the potential for cross-subsidisation of retail activities is of particular concern where a retailer has the potential to sell electricity to customers connected to a local distribution network. TrustPower currently sells approximately [ ] of the total electricity distributed across AIAL's network under an existing UoSA.
98. The Commission considers that, providing the Applicant and any cross-involved directors associated with the Applicant do not participate in any future discussion 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 or retail activities from its lines business.

*Conclusion on Question 2*

99. The Commission considers that, in this case, the granting of an exemption from section 17 of the EIR Act, subject to certain conditions, is unlikely to create

incentives or opportunities to cross subsidise between lines activities and generation or retail activities.

### **Question 3: Requirement for Corporate Separation and Compliance with Arm's Length Rules**

Where applicable, would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between a business that has involvement in electricity lines and a business that has involvement in electricity generation or retail, where those relationships may not otherwise be at arm's length?

100. The EIR Act requires that, where a business is a "connected electricity business", it must comply with the Arm's Length Rules.
101. Section 17D states that a business is a connected electricity business if the business, or a person involved in the business, has an involvement in more than 10 MW of connected generation. Section 3 defines connected generation as meaning generation in which a person is involved that is connected to a line in which the person is involved, if the generation and the line are in the same network area.
102. In this case, TrustPower has no generation connected to AIAL's network and, therefore, the Applicant has no connected generation and is not a connected electricity business.
103. As the Applicant is not a connected electricity businesses, the Arm's Length Rules do not apply.

#### *Conclusion on Question 3*

104. The Commission considers that, as the Applicant is not a connected electricity businesses, there is no requirement for corporate separation or compliance with the Arm's Length Rules.

#### **Conclusion in Respect of the Commission's Criteria**

105. The Commission considers that, provided 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 business selling electricity on AIAL's network other than TrustPower) on AIAL's 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 or retail activities from lines activities.
106. The Commission considers that, as the Applicant is not a connected electricity businesses, there is no requirement for corporate separation or compliance with the Arm's Length Rules.
107. Accordingly, the Commission determines to grant an exemption to HRL Morrison & Co Group Limited from section 17 of the EIR Act, in respect of the cross-involvements outlined in the Application, subject to the following terms and conditions:
  1. neither HRL Morrison & Co Group Limited nor any of its interconnected bodies corporate shall hold a relevant interest (as defined in section 9(2) of the EIR Act) in [ ] of the control rights (as defined in section 9 of the EIR Act) or [ ]

of the equity return rights (as defined in section 10 of the EIR Act) in Auckland International Airport Limited;

2. while HRL Morrison & Co Group Limited is cross-involved with TrustPower and Auckland International Airport Limited, neither HRL Morrison & Co Group Limited nor any of its subsidiaries shall 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 business selling electricity on Auckland International Airport Limited's network 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, 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
3. this exemption is specific to the cross-involvements created through HRL Morrison & Co Group Limited's involvements in Auckland International Airport Limited and TrustPower Limited. It does not extend to any other interest or existing or future cross-involvement of HRL Morrison & Co Group Limited.

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

## **THE COMMISSION'S DETERMINATION**

109. 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 26<sup>th</sup> day of June 2009

Dr Mark Berry

Chair

## NOTICE OF EXEMPTION

The Commerce Commission (Commission), pursuant to section 81 of the Electricity Industry Reform Act 1998 (the EIR Act), exempts HRL Morrison and Co Group Limited 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 TrustPower Limited and Auckland International Airport Limited as outlined in its application for exemption registered by the Commission on 4 September 2008 and subsequently revised on 20 February 2009.

The exemption is subject to the following terms and conditions:

1. neither HRL Morrison & Co Group Limited nor any of its interconnected bodies corporate shall hold a relevant interest (as defined in section 9(2) of the EIR Act) in [ ] of the control rights (as defined in section 9 of the EIR Act) or [ ] of the equity return rights (as defined in section 10 of the EIR Act) in Auckland International Airport Limited;
2. whilst HRL Morrison and Co Group Limited is cross-involved with TrustPower Limited and Auckland International Airport Limited, neither HRL Morrison and Co Group Limited nor any of its interconnected bodies corporate shall 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 business selling electricity on Auckland International Airport Limited's network 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, 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
3. this exemption is specific to the cross-involvements created through HRL Morrison & Co Group Limited's involvements in Auckland International Airport Limited and TrustPower Limited. It does not extend to any other interest or existing or future cross-involvement of HRL Morrison & Co Group Limited.

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 section 81(5) of the EIR Act.

Dated this 26<sup>th</sup> day of June 2009

Dr Mark Berry

Chair

**APPENDIX 1 RELEVANT BUSINESS ACTIVITIES OF THE APPLICANT**

