

IIR Conference
Competition and the Domestic Electricity Consumer
18, 19 November 1997, James Cook Centre, Wellington

**CAN THE COMMERCE COMMISSION PREVENT
ANTI-COMPETITIVE CONDUCT IN THE
ELECTRICITY MARKETS?**

BY DR ALAN BOLLARD AND DAVID AINSWORTH

New Zealand Commerce Commission

INTRODUCTION

This paper is about some of the Commerce Commission's experiences with the electricity industry and also addresses some current industry issues.

New Zealand's approach to the regulation of electricity utilities is called "light handed" regulation. This means an amalgam of the enactment of the Commerce Act, information disclosure and the threat of price control. To some familiar with the costs of the heavier forms of regulation by industry-specific bodies and with the compliance costs visited upon regulated firms, light handed regulation may seem to offer an attractive, less economically distortionary, alternative. However, others may believe that the approach involves regulation that is too light handed, with the result that firms with market power operate without sufficient restraint, to the detriment of consumers and to efficient production.

The Commission's view is that although there are some unresolved difficulties in light handed regulation which could be addressed, the policy, nevertheless, has had important successes for the economy.

UTILITY REGULATION

In New Zealand the main regulatory issue is posed by those utilities where access to an incumbent's essential facility network is necessary for new entrants to compete with the incumbent in the provision of upstream or downstream good or services. The electricity distribution industry contains examples of such networks, access to which is required by electricity retailers who wish to compete with the incumbent power company. Such utilities have an obvious incentive to preserve their monopoly power and profit by:

- hindering access to their distribution networks, either by an outright refusal to supply, or by setting access charges and conditions high enough to render entry unattractive; and
- arranging their accounting systems such that their costs are recovered through their charges to consumers for use of their distribution networks, rather than from charges for the electricity which they supply.

The aim of light handed regulation is to encourage competition in those related markets where entry is possible. If this is to succeed, these types of behaviour must be controlled. The four main components which make up light handed regulation are as follows:

- the natural monopoly and contestable elements of the incumbent firm's business are separated for information disclosure purposes;

- reliance is placed on the Commerce Act to ensure dominant firms do not act anti-competitively;
- industry-specific regulations require the disclosure of information designed to make transparent the operations of companies possessing market power; and
- there is the potential for stronger action in the form of the introduction of price control by the Government.

THE ROLE OF THE COMMISSION IN THE REGULATORY REGIME

The Commission is an enforcement agency which seeks to bring about compliance with the Commerce and Fair Trading Acts. In respect of the Commerce Act the Commission:

- attacks anti-competitive behaviour whether it be collusive behaviour by groups of competing firms, or unilateral behaviour by a dominant firm;
- monitors monopoly pricing; and
- assesses business acquisitions for the acquisition of market power.

Anti-competitive Behaviour

The Commerce Act prohibits restrictive trade practices. These prohibitions apply to all individuals and commercial organisations including State Owned Enterprises and government departments. Restrictive Trade Practices include:

- contracts, arrangements and understandings between competitors that substantially lessen competition in a market (section 27);
- arrangements between competitors that reduce the competitiveness of another rival such as attempts to exclude another competitor from a market by arranging boycotts (section 29);
- price fixing (section 30) and;
- a company, dominant in a market, using that position for the purpose of deterring competition in either that market or another market (section 36).

The Commission enforces these provisions of the Act by either court action or administrative settlements. The penalties for a breach are significant (up to \$5 million for an organisation and up to

\$500,000 for an individual) and the Courts are showing some tendency to impose higher penalties on offenders.

Monopoly Pricing

The Commerce Act provides for the introduction of price control by the Government in circumstances where there is limited competition in a market, and it is desirable in the interests of consumers for prices to be controlled. The Commission can recommend the imposition of price control or alternatively may be asked by the Government to report on the necessity of such a step. These are the only powers the Commission has with respect to monopoly pricing and that fact is commonly misunderstood.

No items have yet been put on price control under the 1986 Act. Nevertheless, the Commission regards this instrument as a credible part of its duties.

Business Acquisitions

The Act generally prohibits any firm from acquiring or strengthening a dominant position in a market by business take-over or merger. However, if it can be shown that the public benefits resulting from such a transaction are greater than the detriments arising from the loss of competition, it may be authorised by the Commission.

Business acquisitions which do not give rise to dominance concerns can be given clearance by the Commission and this protects the acquisition from challenge under the Act by other parties. The clearance process does not allow for consideration of public benefits.

The Commission undertakes market surveillance to ensure that any un-notified acquisition that may lead to dominance concerns is identified for potential court action. The Commission will not hesitate to prosecute in the appropriate circumstances.

THE COMMISSION'S EXPERIENCE WITH THE ELECTRICITY INDUSTRY

Fair Trading Act Issues

Most of the interaction between the Commission and electricity industry players has concerned the Commerce Act. However, significant Fair Trading Act issues have also arisen.

The Consumer Guarantees Act (which came into force in April 1994) provides that manufacturers and suppliers of goods and services in New Zealand must furnish domestic consumers with certain guarantees relating to the supply, title, quality and fitness for purpose of goods and services and it

gives consumers particular rights of redress if those guarantees are not fulfilled. That Act also provides that suppliers and manufacturers may not contract out of such guarantees and that consumers have rights of action directly against both manufacturers and suppliers.

These rights are independent of any contracts between the manufacturer and consumer or the manufacturer and the supplier. Suppliers and manufacturers have joint and several liability to consumers for the guarantees as to acceptable quality and correspondence with description which cannot be avoided. It is the consumer who has the choice of which party to claim redress against. While the Consumer Guarantees Act is not enforced by the Commission, section 43 of the Act states that it is a breach of the Fair Trading Act to purport to contract out of the Consumer Guarantees Act. The Commission initiated an investigation as to whether power companies have done just that in their connection contracts with domestic consumers.

ESANZ, representing the power companies, is arguing that electricity is not a good or a service for the purposes of the Consumer Guarantees Act and, therefore, the Act does not apply to the connection contracts of domestic electricity consumers. It bases this argument on the fact that although electricity is specifically defined as a good in both the Commerce and the Fair Trading Acts, the Consumer Guarantees Act is silent as to the status of electricity. The Commission's view is that the supply of electricity to domestic consumers must comply with the statutory guarantees. ESANZ has sought a declaratory judgment on the issue and the two parties are currently awaiting Court time to argue the matter.

If the Court determines that electricity is a good and/or a service in terms of the Consumer Guarantees Act, the Commission will expect all transgressing power companies to amend their domestic consumer connection contracts. Failing that, the Commission will investigate whether to prosecute under the Fair Trading Act. The Consumer Guarantees Act requires that manufacturers (as well as suppliers) provide certain guarantees to domestic consumers. The Commission presently is inclined to the view that generators and Trans Power fit the Act's definition of manufacturer. It may therefore be necessary for the power companies, generators and Trans Power to come to terms with the implications of the Act.

Commerce Act Issues

Business Acquisitions

The Commission has now dealt with about 25 business acquisitions which involved mergers between power companies. The Commission's methodology in dealing with such acquisitions and views regarding the relevant markets have received the approval of the High Court and Court of Appeal in the *Power New Zealand v Mercury Energy* case. The industry can now regard the law as being well settled in respect of future mergers between power companies.

Briefly, the Commission's approach to power company mergers has been that when two dominant networks merge, no additional market power is obtained by the enlarged dominant network company in the distribution market. Similar arguments apply to the delivered electricity market to small consumers.

That leaves the national electricity retail market¹. The Commission in its "Business Acquisition Guidelines" notes that a dominant position in a market is generally unlikely to be created by a merger if the merged entity has less than about 40% share of the market (or a 60% market share if another competitor exists with at least a 15% market share).

The Commission has noted some adverse comment in the media in respect of its decision to grant a clearance to Mercury Energy and UtiliCorp to form an business alliance which will result in Mercury Energy, Power New Zealand, WEL Energy Group and Bay of Plenty Electricity being considered, in competition law terms as one unit. The Commission noted in its staff report on the matter that on the basis of electricity retailer incomes² the merged entity would have about 36% of national electricity sales by power companies. It also noted that the sales volume of the merged entity to the commercial and industrial sector (which might more closely correspond to the national retail market) would be about 40% of such total sales volumes. Given my previous statements, it is clear therefore that any further proposals to increase the size of the Mercury Energy/Power New Zealand/WEL Energy/Bay of Plenty Electricity agglomeration by take-over or merger would be given careful scrutiny by the Commission to determine whether competition concerns arose. The Commission disagrees with the view of some commentators that its merger methodology would allow an unending succession of take-overs leading eventually, to one power company supplying most of New Zealand.

The Commission has recently dealt with the issue of inter-fuel competition between electricity and natural gas in its consideration of an application for the authorisation of Powerco's acquisition of Egmont Electricity. Inter-fuel issues arose as a result of Powerco's ownership of a small gas distribution and retailing operation in Hawera, Manaia and Normanby. In the Commission's view those gas sales provided a constraint on the operations of Egmont Electricity and vice versa, in those towns. The Commission authorised the acquisition because Powerco was able to show that the public benefits resulting from the merger were larger than the detriments resulting from such a loss of inter-fuel competition.

However, I would say to other energy companies who may be contemplating inter-fuel mergers that this was a case which very much turned on the fact that there were only about 3,500 electricity and natural gas consumers who were affected by a loss of inter-fuel competition. This meant that the competitive detriment was always going to be small in comparison to the benefits resulting from the rationalisation of the electricity supply operations to a much larger number of electricity consumers.

More to the point in respect of future potential inter-fuel mergers is the Commission's statement in its Enerco/Capital Power Draft Determination that there were significant detriments likely to result from the acquisition of Capital Power by Enerco [and by implication, that significant public benefits would have to be shown before the Commission could authorise the acquisition].

Enforcement of the Restrictive Trade Practice Provisions of the Act

The Commission's approach after deregulation was to make efforts to familiarise industry participants with the reach of the Act and to give dominant players in the industry a breathing space to become familiar with the regulatory regime. The Commission carried out a programme of visits to every power company where the implications for the industry of the Commerce and Fair Trading Acts were explained to senior executives. Further, the Commission did not immediately take enforcement action when its monitoring programme showed that many power companies put no administrative measures in place for a considerable time to allow access to their networks by other competing retailers, and as a result simply refused to allow such access.

However, the Commission considers that this honeymoon period has long since expired, and is taking enforcement action as necessary.

In taking such enforcement action, the Commission understands the high costs of litigation on both sides and often will be prepared to negotiate an administrative settlement. This may require the offender to admit liability, to formally promise to modify behaviour and to agree to publicity. Typical administrative settlements which the Commission has arranged with electricity industry players are as follows:

- It was agreed by Westpower that qualified linesmen could work on the company's poles in order to install a transformer and associated equipment belonging to a farmer who was providing his own reticulation. A feature of the settlement was that the Commission agreed that Westpower could charge a reasonable rent for the use of the pole.
- Mercury Energy agreed to remove charges associated with access to its network by independent retailers after learning of the Commission's views that such charges were anti-competitive.
- Tasman Energy agreed to connect a privately reticulated subdivision to its network with fuse, rather than much more expensive circuit breaker protection, and that the time-of-use metering associated with the subdivision could be carried out at 400 volts rather than 11 kV (with a calculated allowance made for transformer losses).

However, in some circumstances it is necessary for the Commission to carry out its enforcement duties by way of prosecution in the High Court. Reasons for this may be because of the resistance of the defendant to an administrative settlement or because of the need to clarify the law.

The Commission is presently prosecuting Southpower under sections 27 and 36 of the Commerce Act. The Commission is alleging that the manner in which:

- Southpower charged for access to its network (an access agreement negotiation fee of \$1,000, a fixed charge of \$40 per month per entrant retailer using its network and a charge of \$30 per month per consumer which the entrant supplied with electricity); and
- Southpower allocated its costs between its monopoly network business and its contestable electricity retail business,

was anti-competitive.

The case has not proceeded as fast as the Commission would like. It is presently proceeding through a series of interlocutory hearings in the High Court about matters such as the statement of defence which Southpower has filed. The Commission is most anxious to advance to a full court hearing and anticipates that a substantive hearing will occur in the middle of 1998.

CURRENT ISSUES IN ELECTRICITY MARKETS

Generation and Wholesale Electricity Markets

ECNZ's Market Power

Although the Commission has not had to formally analyse this question recently, there are a number of factors which could mean that ECNZ is (post the Contact Energy split off) still in a dominant position in the generation and wholesale electricity market. Some of these factors are:

- ECNZ's high current market share of about 70%;
- its ownership of Huntly, the marginal power station over a large range of output which has the ability to operate on two fuels;
- the degree of operation flexibility which ECNZ's possession of the largest hydro water storage system (the Waitaki Valley) and Huntly power station gives it; and
- given their proximity to the major load centres, ECNZ's ownership of all the North Island hydro power stations.

Having said that, I must record that the Commission has received neither informal market intelligence nor formal complaints that ECNZ is using its market power in the generation and wholesale markets a manner that would put it at risk of breaching section 36 of the Commerce Act.

As an aside, I note that the Commission is unlikely to have concerns, given the present shape of the electricity markets, were ECNZ to vertically integrate into electricity retailing and indeed, could regard such an outcome as pro-competitive. However, should ECNZ remain dominant, any such retail/wholesale activities would have to be closely monitored by the Commission. Likewise, if a power company were to purchase one of the SOE generators (should Government policy ever allow such a sale) the Commission would presently be unlikely to have concerns about such integration into upstream markets.

A Further Split of ECNZ?

Contact Energy and ECNZ are presently competitors with a common ownership (the Crown). This is the first situation where SOE's are competing among themselves. The Commerce Act provides specifically that it applies to the Crown. Therefore, it is necessary in such a situation that care is taken by Officials and indeed Ministers that they do not place themselves or their organisations at risk of breaching the restrictive trade practice provisions of the Commerce Act in respect of collusive pricing or market sharing. If ECNZ is further split, that risk might be exacerbated.

As I have said, ECNZ is arguably dominant in the generation and wholesale market. Therefore, from the Commission's narrow perspective, the potential arrival of a further competitive force in the generation and wholesale market can be nothing but good. However, there may well be broader issues to be considered.

The New Zealand Electricity Market

The Commission has some knowledge of the New Zealand Electricity Market, gained during its consideration of EMCO's application for authorisation of the NZEM rules relating to pricing mechanisms, prudential provisions, and the adoption of the MARIA metering standards. During the authorisation process there were concerns expressed by some parties that the price of electricity traded through NZEM was to be set on an ex-post rather than an ex-ante basis and that this reduced the ability of electricity purchasers to manage demand. The Commission continues to hear arguments that the market price should be set ex-ante and that the generators should cover their risk with a margin on their bid prices. However, our view is that these factors bear on who carries the risk and not on the level of competition in the market. The market structure was created by its participants and the Commission certainly does not see a role for itself in re-organising NZEM.

The Commission saw the development of the wholesale market as being desirable, with benefits to the economy as a whole. It did not consider that the particular provisions it had been asked to authorise lessened competition. As such, authorisation for the rules was neither required nor within the jurisdiction of the Commission.

The Commission emphasised that its decision should not be taken as an endorsement of the MARIA agreement, nor does it provide MARIA with any protection from possible action by the Commission or other parties under the Commerce Act. The Commission, in its decision, foreshadowed possible future investigation of MARIA should circumstances warrant it.

The Commission has recently received a number of complaints from electricity retailers regarding the initial proposals for EMCO's fee structure for NZEM participants. In particular, independent retailers were concerned over the high fixed charge components of EMCO's initial proposals arguing that a fixed charge for reconciliation at each grid exit point disadvantaged entrants vis-à-vis incumbents. The Commission was concerned by matter and established a case file to investigate the matter. The Commission is aware that NZEM participants have reconsidered the fee structure and, as a result, it now appears to have a more even competitive balance between entrant and incumbent retailers.

The MARIA Agreement

The MARIA agreement is an arrangement between competitors. Such agreements are of a type to which competition law authorities throughout the world pay close attention. I have mentioned that the Commission has left open its options for investigation of, and potential future action regarding, MARIA. Although the Commission has received some critical comment concerning some provisions of the agreement, no formal complaints have been made and we have no current investigations in place.

However, the issue of metering standards and their different application to entrants and incumbents remains a thorny problem which the Commission may wish to take a further look at. The Commission understands that there is a large difference between the cost of MARIA-compliant time-of-use meters which entrant retailers must use and those time-of-use meters which incumbent retailers have used quite satisfactorily for some time, to accurately measure consumption for revenue purposes. The Commission cannot understand the reason for this disparity but does believe that it represents a barrier to the entry of retailers.

Trans Power Issues

Trans Power at first sight appears to be a pure natural monopoly which (apart from its National Reconciliation Manager role) does not operate in any contestable market. Therefore, it could be

argued that it would be unlikely that Trans Power could breach section 36 of the Commerce Act (use of market power for anti-competitive purpose) as it has no competitors and could not have a rational anti-competitive purpose.

In 1993 the Commission received an application from Trans Power for authorisation of its customer connection contracts. Trans Power was concerned that the fixed charge element of those contracts was arguably anti-competitive vis-a-vis, embedded generation. Trans Power withdrew its application before the matter was finalised. The Commission understands that Trans Power has subsequently revised its customer connection contracts such that they now allow potential generation embedders to plan a lower nominated requirement for Trans Power capacity as and when their project comes on line.

However, we are not sure that the embedded generation issue has completely vanished. It seems to us that Trans Power has incentives to deter embedded generation projects which compete with its substation and transmission assets, and that there remains the potential for Trans Power to use its market power for anti-competitive purpose in this respect.

Downstream Markets

The Commission's Views

It is the Commission's view that the behaviour of many (but I hasten to add not all) of the integrated power companies in respect of the entry of independent retailers onto their networks has been in the past, and still is, in danger of breaching the Commerce Act. This anti-competitive attitude manifests itself in combinations of the following examples:

- long initial delays in the development of the use-of-system/conveyance agreement device to allow off-network trading by independent retailers. The Commission has always been concerned that these contracts were not necessary in the first place and notes that Electro Power (before being subsumed into Central Power) allowed entry by retailers, merely on the basis of its standard terms and conditions;
- refusal to acknowledge the presence of access seeking independent retailers by failing to respond to correspondence;
- the introduction of negotiation and access fees for independent retailers. The Commission has asked itself why would a distributor with revenues of millions of dollars from line charges expend so much development and negotiating time with respect to fees that at most would raise only a few thousand dollars of revenue. The Commission notes that none of the large power companies now insist on such fees but that many of the smaller ones do;

- the insistence on higher metering standards for independent retailers than themselves which I have mentioned above;
- the recovery of costs almost entirely through the monopoly parts of their businesses which I have mentioned above;
- anecdotal evidence that upon the arrival of an independent retailer at the door of a large customer, some power companies offer a reduced line charge to the customer in return for retention of the business by, for example, devices such as the recalculation downwards of the customer's assessed capacity; and
- the use of profit rebates in a manner which deters the entry of retailers.

Potential Changes to Downstream Electricity Policy

The Commission understands that some of the policy options which the Government is presently considering with respect to downstream electricity markets are:

- the strengthening of information disclosure;
- corporate or ownership separation of distribution and retailing; and
- the establishment of guidelines with respect to power company charges.

The Commission finds information disclosure useful in its roles of monitoring behaviour and monopoly pricing in the industry and would welcome the strengthening of this process. Proper separation of distribution and retailing is the major plank of the Commission's case against Southpower so quite clearly we support any moves along these lines. Finally, price control is a tool available under the Commerce Act and the industry should be clear it can happen.

It may be that corporate memories are fading as to what working under heavy handed regulation can mean. I have just returned from addressing a conference in Melbourne on utility regulation where I defended New Zealand's light handed regulation approach against Australian, and US scepticism. As the downstream electricity industry appears to me to be flirting with a re-introduction of heavy handed regulation I thought I might note what this means in Victoria.

The operations of power companies are supervised by, not only the Australian equivalent of the Commerce Commission (ACCC), but also by the Office of the Regulator General (which determines electricity pricing), the National Electricity Code Administrator, the National Electricity Market Company, the Victorian Power Exchange, the Chief Electrical Inspector and the Electricity Industry Ombudsman.

As to some examples of what the industry makes of all this, I listened to a power company executive asking why it was necessary for the Victorian electricity pool manager, sensing a potential capacity problem this summer, to pre-empt the market by purchasing non-pool reserve generation capacity at a cost of A\$25 million. I heard him tentatively suggest that it might lead to better investment decisions if grid system augmentations (such as a proposed new interconnect between Victoria and South Australia) rather than being centrally planned by regulators with regulated rates of return, were built by private risk capital. He also noted that that focus of power company managers was more on the regulatory regime and its consequences and less on innovation and development.

Deemed Profile Reconciliation

The Commission was approached by Southpower and United Electricity to indicate its views with respect to the deemed profiling trial currently in progress. The issue was whether the two companies, in competition with each other, had an arrangement to share their markets in an anti-competitive manner. The Commission did not believe the trial, given its limited scope and duration, substantially lessened competition and said so to the companies. We understand that the trial is to attempt to prove the technical feasibility of the concept of deemed profiling so that such technical factors cannot be used by power companies to rebuff the later extension of the concept on other networks. The Commission is monitoring the trial with interest but would not wish to see any long term market sharing arrangements such as this put in place.

THE COMMERCE ACT AND THE COURTS

Amendments to the Act

I have been asked to mention the need or otherwise for the strengthening of the Commerce Act. The Commission is not a policy body, it is an enforcement agency. It has no responsibility to decide on amendments to the Act. Therefore, all I will do is to note that at various times the following suggestions have been made regarding amendments to the Act:

- reduce the threshold for liability under section 36 from dominance to substantial market power. However, such an amendment would not impact in a major way on the electricity industry because dominance already exists with respect to ECNZ (arguably), Trans Power and the power company distribution businesses;
- because of the evidential difficulties in proving an anti-competitive purpose in the corporate mind, amend section 36 to include liability for a use of dominance for an anti-competitive effect (along with anti-competitive purpose). In fact, this idea has been taken up to some extent by the Courts. The Courts have referred the ability to infer purpose from observed conduct or effect.

- some of the section 44 exceptions (such as those relating to overseas shipping) might be removed although none of them concerns the electricity industry; and
- overrule the decision of the Privy Council in *Clear Communications v Telecom* which permits network access pricing to include lost monopoly profits (the so called Baumol-Willig rule). In this respect the Commission notes that the Government has said that it would be concerned to see the rule being applied here in future and that if necessary it would initiate price control. This is relevant to the electricity industry as presumably a power company could claim lost monopoly profits from retail operations as part of its access fee. The Commission does not believe the application of the Baumol-Willig rules gives carte-blanche to monopolists to exclude competition.

The Court Process

Of greater concern to the Commission is the difficulty which the Commission has with the Court process in general. That is firstly having deep pocketed defendants using pre-trial appeals on interlocutory matters to avoid or postpone a substantive hearing, and secondly in gaining access to Court time for the necessary lengthy hearings required by some cases. Such delays impose unwarranted extra costs on both the Commission and private litigants and indeed on the Courts themselves.

Legal costs may be the reason for one surprising feature of the electricity industry in respect of the Commerce Act. To our knowledge, apart from a single filing of proceedings in respect of consumer rebates by Power New Zealand which resulted in a rapid settlement with the Auckland Energy Consumer Trust, and Geotherm's case against ECNZ, there has been no private Commerce Act litigation by competitors within the industry. This is perhaps surprising, because the industry is large and well resourced (particularly in comparison with the Commission whose activities and budget which must be spread over all areas of the economy) and there are many areas of dispute. For example, if an industry participant is convinced that off-network trading on the basis of deemed profiles is feasible but is refused network access by a power company on that basis, the normal approach would be to file private proceedings alleging a breach of section 36.

CONCLUSION

The message I would like to leave you with today is that the Commission's role is somewhat different from that of most overseas industry specific electricity regulatory bodies, in that the Commission enforces general legislation, for the promotion of competition as a means of increasing efficiency. The area of electricity is challenging to monitor and enforce due to the natural monopoly characteristics of networks, which give rise to issues of dominance and access.

The investigations concerning breaches of the Act which we carry out in the network industries area of our work, of which electricity is one, often have a different flavour to those in other areas of New Zealand's commerce. For example, an investigation into allegations of price fixing in, for example, the meat or car industries, will be focused on obtaining the facts of covert behaviour by the price fixers. If such information is properly obtained the case will usually easily be made out. However, alleged anti-competitive behaviour by network industries is usually on-going overt behaviour (a published pricing structure, bundling of charges, refusal to grant access, published access charges) and the issue for the Commission and the Courts is to carry out the economic and legal analysis necessary to determine whether the behaviour breaches sections 27 and 36 of the Commerce Act.

The Commission when weighing up the successes and difficulties I have discussed in my address believes that deregulation of the industry has resulted in important advances for the economy. It further believes that there is a broad degree of understanding and compliance with the Commerce Act, and that the efforts the Commission and others are putting into promoting competition in the electricity retail markets will bring desirable incentives on power companies to reduce costs and lower prices to consumers.

However I should point out that, even given the success of these efforts, there remains the obvious point that the distribution of electricity is a natural monopoly. The owner of the lines will remain in a monopolistic position even if, for example, the retail side of its business is split off or ring fenced in some way. I consider that it is the lack of competition in the line business which has created greatest potential for consumer harm in the past, and that future reforms which might be introduced, will only ameliorate that situation to an extent, not cure it. Given the natural monopoly, there can never be a perfect competitive outcome. However, the real issue is the comparison between the competitive process and efficiencies obtained under the Commerce Act with those under the heavy handed regimes existing in other countries with similar economies.

Finally, I can tell you that it is business as usual at the Commission during the present policy revamp. The Southpower prosecution, restrictive trade practice investigations and the Commission's monitoring of information presently disclosed are all continuing.

¹ The Commission's view of the boundary between the delivered electricity market to small consumers and the national electricity retail market was that it lay between a consumer size range of 0.1 to 0.5 gigawatt-hours per year. Recent experiences would probably incline the Commission to a view that the boundary now lies towards the upper end of that range.

² Which parameter was used to determine market concentration by the High Court in *Power New Zealand v Mercury Energy*.