

***The Changing Profile and Future Direction of  
New Zealand's Electricity Industry Conference***

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# **Convergence of Light and Heavy Handed Regulation**

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## **Introduction**

The period following the passage of the Electricity Industry Reform Act (EIR Act) in July 1998 has been an exciting one for industry participants. We have already seen new entrants in the retail sector, and significant merger and acquisition activity in both lines and retail markets. In the EIR Act, the government has created industry specific regulation, mandating corporate separation of lines and energy businesses by April 1, 1999, with ownership separation to follow. This is structural regulation, and most people would probably characterise these new rules as heavy-handed. The government also signalled its intention to regulate the impact of lines business pricing on, at least, two specific classes of customer: domestic and rural. The mechanism for identifying the need for price restraint regulation for specific classes of customer is likely to be some increased requirements in disclosure regulation. Should the Ministry of Commerce decide that lines companies were using their monopoly position to obtain monopoly rents from the specific customer groups, the Ministry could regulate prices. The general provision for price control is present already in Part IV of the Commerce Act, but the EIR Act adds a specific target behaviour in the electricity sector that is absent in the rest of the economy. These moves are a departure from the general light-handed approach to regulation specifically for the electricity sector, and are the first targeted regulations since the passage of the Commerce Act (1986).

The Commerce Commission is not a policy body, and does not comment on the decision to treat the electricity sector differently from the rest of the economy. The Commission made comments on the draft bill, specifically with regard to the new roles being created by the Bill for the Commission. Since the passage of the EIR Act, the Commission has adopted a set of

principles for carrying out its obligations in the enforcement of the Act, and I will describe those principles today.

In general terms, the broad based light-handed regulatory framework set up in the Commerce Act (1986) has some benefits over the very costly heavier handed regimes elsewhere. As part of my doctoral dissertation, I surveyed US regulators about telecommunication pricing, an exercise that involved 192 individual regulators in 51 separate jurisdictions. I became quite intimate with the scope of a pricing decision in terms of the huge amount of information that had to be prepared over months by small armies of staff for both the company and the regulators, to say nothing of the inputs of highly organised lobby groups. There are, of course, highly developed arguments for imposing and continuing that kind of behaviour, and just as highly developed arguments for its abolition. The natural monopoly elements of electricity and other utilities present difficulties in all regimes, and different regimes have chosen different mechanisms for controlling the impacts of those particular distortions in the competitive process. The recent choice of electricity sector specific regulation may signal an impatience with the pace of changes in electricity prices, especially for domestic (captive) consumers, under the light-handed approach. The real difficulties with any of the choices for a control mechanism is the inability to conduct a controlled experiment. The decision-maker can have but one set of rules running at a time, which precludes finding out what would have happened with a different choice.

From the Commission's perspective, of course, the current set of rules is the one we have to enforce, and we are confident that there will always be people who will say we are too light-handed, and those who will say we are too heavy-handed. We would probably become quite concerned if that balance of criticism were to suddenly become one-sided.

## **The EIR Act**

Several sections of the EIR Act create new roles for the Commerce Commission, but the Act does not specify the weight of the hand that the Commission should wield in order to fulfil its new roles. The Commission has adopted the initial position regarding the EIR Act that its purpose along with the Commerce Act and the Fair Trading Act, is to promote competition, albeit in different ways. All three acts proscribe certain behaviours by persons in markets in New Zealand. The Commerce Commission's enforcement practice is limited to breaches of the Commerce and Fair Trading Acts that have a detrimental effect on competition, and our approach to enforcement of the EIR Act should be expected to result in similar practices. The Commission is unlikely, at least in the near term, to attack situations where a technical breach may have occurred, but where competition effects are negligible. In this regard, at least, we would consider the Commission to be maintaining a light-handed regulatory approach to enforcement of the EIR Act. A complete analysis of the Commission's interpretation of its role under the EIR Act is contained in the Commission's Practice Note 3, which is attached to this address as an appendix.

Having said that the Commission is unlikely to attack breaches of the EIR Act which do not affect, or are not likely to affect competition, it may well be that the Commission could use this new Act to good effect in a situation that is fundamentally a breach of the Commerce Act. A possible scenario would be that the Commission was investigating, say, a lines company under Part II of the Commerce Act, and decided that a breach of, say, Section 36 had occurred. Section 36 breaches are recognisably difficult to prove. In the course of the investigation, it might come to light that the same company was behaving in a way that

constituted a breach of the EIR Act. This breach might be more easily objectively proven in court, and carries the same potential penalties, as does the Commerce Act. In this sense, the EIR Act should be seen as another tool to obtain the benefits of competition in markets in New Zealand, if only in the electricity sector.

## **The Commerce Act (1986)**

The Commission has a role in monitoring structural changes and behaviour in markets in New Zealand. The Commission:

- monitors anti-competitive behaviour, whether by groups of competing firms or by dominant firms (Part II of the Act);
- monitors “monopoly” pricing and any need for price control (Part IV of the Act);
- assesses business acquisitions (Part III of the Act); and
- authorises restrictive trade practices and clears or authorises business acquisitions (Part V of the Act).

### ***Anti-competitive Behaviour***

Part II of the Act prohibits a number of restrictive trade practices. Unless exempted, the prohibitions apply to all individuals and firms, including state-owned enterprises and government departments. Restrictive trade practices which contravene the Act include:

- contracts, arrangements and understandings between competitors which substantially lessen competition in a market (section 27);

- covenants which substantially lessen competition in a market (section 28);
- contracts, arrangements and understandings which contain exclusionary provisions. An exclusionary provision is one which has the purpose of preventing, restricting or limiting dealings with a particular person or class of persons (the target) whether absolutely or in particular circumstances or on particular conditions by all or any of the parties to the contract, arrangement or understanding which contains the exclusionary provision (the boycotting parties) (section 29);
- price fixing (section 30);
- a firm, dominant in a market, using that position for the purpose of restricting, preventing, deterring or eliminating competition in either that market or any other market (section 36); and
- resale price maintenance by suppliers (section 37) and third parties (section 38).

Owners of utility lines businesses are likely, by definition, to be in a dominant position in a market. As such, they will be subject to the section 36 requirements and must comply with them. Specifically, firms which have a dominant position in a market must not use that position for the purpose of:

- restricting the entry of any person into that or any other market; or
- preventing or deterring any person from engaging in competitive conduct in that or any other market; or
- eliminating any person from that or any other market.

However, section 36 does not prevent a dominant firm from using its market power for purposes other than those proscribed. For example, the charging of prices above the

competitive level is not, in itself, prohibited by the Act. The expectation is that emerging competition, or technological change, or the threat of further regulation, such as by price control pursuant to the Act or new legislation or regulation, will deter monopoly pricing by utilities.

Any person who wishes to engage in a restrictive trade practice which might contravene any of the provisions of the Act noted in paragraph 10 of this paper (except for section 36) may apply to the Commission for authorisation to engage in that practice. The Commission may grant such an authorisation if it is satisfied that engaging in the restrictive trade practice will be likely to result in public benefit which would outweigh the lessening in competition that would be likely to result from engaging in the restrictive trade practice.

### ***Price Control***

Part IV of the Act provides for the imposition of price control. The Government may ask the Commission to report on the necessity or desirability of price control for any goods or services. The Commission, of its own motion, may recommend price control.

### ***Business Acquisitions***

Part III of the Act prohibits the acquisition of assets of a business or shares if, as a result of the acquisition, the acquirer or another person would be likely to acquire or strengthen a dominant position in a market.

The Commission carries out market surveillance to ensure that any acquisition which might give rise to dominance concerns is identified and examined and appropriate action then taken.

Part V of the Act provides that a person who proposes to acquire assets of a business or shares may give the Commission a notice seeking clearance or authorisation for the acquisition. If the acquisition does not give rise to dominance concerns, then the Commission may give a clearance for the acquisition. If the acquisition does give rise to dominance concerns, then the Commission may grant an authorisation for the acquisition if it is satisfied that the acquisition will be likely to result in public benefits that outweigh any detriments.

As I mentioned earlier, we are seeing significant levels of activity in the merger and acquisition arena as firms deal with the structural requirements of the EIR Act. We expect to see more, and would just point out that acquisitions in the electricity industry are subject to the same Commerce Act considerations as any other industry. The Commission has published its Business Acquisition Guidelines, and copies are available on request.

## **Back to the EIR Act**

### ***EIR Act Exemptions***

The new roles under the EIR Act which are comparable to the Commission's adjudication roles under the Commerce Act raise some interesting issues. The Commission is charged with granting exemptions to the EIR Act (Section 81), in situations where an entity is caught by one of the "bright line" prohibitions, but where the purposes of the Act are not thwarted by the granting of an exemption. The fee for the exemptions' application has been fixed by regulation at \$10,000 plus GST. The Commerce Commission has identified a number of entities that are likely to be in breach of the EIR Act if they do not either achieve corporate

separation of lines and supply businesses by April 1, 1999 or acquire an exemption to the terms of the EIR Act. April 1, 1999 is a mere five months away, and the Commission has not received any applications for exemptions. I would like to take this opportunity to remind potential applicants that the EIR Act does not specify a time period for the consideration of such applications, and that the procedures for these applications are untested. The Commission will be bound by statutory deadlines in the Commerce Act in the event that applications under the relevant sections of that Act are received while applications under the EIR Act are being processed. In other words, delaying application under the EIR Act could result in exposure to attack by third parties, should any be so inclined.

In addition to expressing the concern we have over the apparent reluctance to apply for exemptions, I would like to emphasise the Commission's view that the EIR Act does not allow the Commission to apply a public benefits test in granting exemptions, as it does in applications for authorisation under Sections 58 and 67 of the Commerce Act. The only test specified in the EIR Act is consistency with the purposes of the Act. The purpose of the Electricity Industry Reform Act 1998 (EIR Act) is to reform the electricity industry to better ensure that:

- (a) costs and prices in the electricity industry are subject to sustained downward pressure; and
- (b) the benefits of efficient electricity pricing flow through to all classes of consumers

by –

- (c) effectively separating electricity distribution from generation and retail; and
- (d) promoting effective competition in electricity generation and retail.

The EIR Act is split into eight parts, arranged as follows:

- Parts 1 to 5, which, in accordance with the *ownership separation rules*, provide for the separation of electricity distribution (electricity lines businesses) and generation and retail (electricity supply businesses). The particular purpose of Parts 1 to 5 is:
  - (a) to prohibit 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) to restrict relationships between electricity lines businesses and electricity supply businesses which may otherwise not be at arms length.
- Part 6, which enables regulations to be made in respect of charges relating to line function services to domestic premises and to consumers in sparsely populated areas.
- Part 7, which enables regulations to be made to facilitate competition among electricity retailers and choice for consumers.
- Part 8, which enables the split of Electricity Corporation of New Zealand Limited.

In Practice Note 3, the Commission has identified three questions that it considers key to the granting (or not) of exemptions. These are:

- Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to inhibit competition in the electricity industry?

- Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses?
- Would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between an electricity lines business and an electricity supply business which is not at arms length?

The presumption must be that if the answer to any of these questions is “yes”, the Commission must not grant an exemption from the EIR Act. Again, I must emphasise that in the absence of experience in processing applications for exemptions, the Commission expects the process to proceed slowly and deliberately for the first few at least.

### ***EIR Act Extensions***

For completeness, I should also mention that the Commerce Commission is charged with creating extensions to the EIR Act if it believes that an entity exempted by the Act itself should not be exempted any longer. As indicated in Practice Note 3, the Commission does not expect to have to apply this section of the EIR Act often.

### ***Conclusion***

In conclusion, I would like to thank the organisers of this conference for the opportunity to address you today. The challenge in the electricity industry, and what would seem to be the basis for the EIR Act, is to achieve the benefits of competition in an industry that is built on a natural monopoly. Electricity is certainly not alone in facing that challenge, but it is currently alone in having dedicated regulation. The Commerce Commission’s role in all sectors of the economy is to enforce the existing legislation to the best of our ability with an even hand.



COMMERCE COMMISSION

## Practice Note No. 3

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### Electricity Industry Reform Act 1998 Commission's Role and Processes

The Electricity Industry Reform Act 1998 (EIR Act) was enacted by Parliament on 3 July 1998. The EIR Act is a major Government reform targeting the generation, local distribution and retail sectors of the electricity industry. The aim of the reform is to benefit all electricity consumers by making these sectors more efficient through the promotion of effective competition in generation and retail markets, and by curtailing the natural monopoly powers of local distribution networks.

The purpose of this Practice Note is to give assistance to those parties likely to be affected by the EIR Act and to their advisors by:

- identifying those areas of the EIR Act providing for the Commission to have a role, and which bear upon that role; and
- indicating the processes the Commission will apply in fulfilling that role.

While this Practice Note will not cover every eventuality and permutation which might arise in respect of the Commission's role under the EIR Act, it should provide a useful, general guide. However, it is not intended as a substitute for legal advice and, given the complex nature and scope of the EIR Act, any parties to whom it is likely to apply should seek appropriate legal advice.

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## THE PURPOSES OF THE ELECTRICITY INDUSTRY REFORM ACT 1998

The purpose of the Electricity Industry Reform Act 1998 (EIR Act) is to reform the electricity industry to better ensure that:

- (e) costs and prices in the electricity industry are subject to sustained downward pressure; and
- (f) the benefits of efficient electricity pricing flow through to all classes of consumers

by –

- (g) effectively separating electricity distribution from generation and retail; and
- (h) promoting effective competition in electricity generation and retail.

The EIR Act is split into eight parts, arranged as follows:

- Parts 1 to 5, which, in accordance with the *ownership separation rules*, provide for the separation of electricity distribution (electricity lines businesses) and generation and retail (electricity supply businesses). The particular purpose of Parts 1 to 5 is:
  - (b) to prohibit certain involvements in electricity lines businesses and electricity supply businesses which may create incentives or opportunities –
    - (iii) to inhibit competition in the electricity industry; or
    - (iv) to cross-subsidise generation activities from electricity lines businesses; and
  - (b) to restrict relationships between electricity lines businesses and electricity supply businesses which may otherwise not be at arms length.
- Part 6, which enables regulations to be made in respect of charges relating to line function services to domestic premises and to consumers in sparsely populated areas.
- Part 7, which enables regulations to be made to facilitate competition among electricity retailers and choice for consumers.
- Part 8, which enables the split of Electricity Corporation of New Zealand Limited.

## COMMISSION'S ROLE UNDER THE EIR ACT

The Commission considers that its role under the EIR Act can be accommodated within the existing approaches and operations of its Commerce Act Division. The Division is responsible for encouraging compliance with the Commerce Act 1986, and seeks to achieve that in two main ways:

- Commerce Act *enforcement*, which relates to the enforcement of statutory prohibitions in respect of restrictive trade practices, business acquisitions and goods or services which are subject to price control; and
- Commerce Act *adjudication*, which relates to the operation of the statutory schemes by which business acquisitions may be cleared or authorised, and restrictive trade practices and prices for controlled goods or services may be authorised.

The Commission sees its role under the EIR Act neatly falling into enforcement and adjudication areas in a similar way.

The following table shows the key sections of the EIR Act where the Commission has a potential role, and whether the Commission would carry out that role as an enforcement matter or an adjudication matter. In this context:

- *enforcement* refers to the Commission dealing with a potential or alleged contravention of a relevant section of the EIR Act; and
- *adjudication* refers to the Commission considering and adjudicating on a matter under a relevant section of the EIR Act.

*Table: Summary of the Commission's Responsibilities under the Electricity Industry Reform Act*

Section of the Act	Description	Enforcement	Adjudication
17, 18, 20	Part 2	Ownership separation rules	✓
24	Part 2	Requirement for corporate separation	✓
25	Part 2	Requirement for compliance with arms length rules	✓
30	Part 2	Ban on expansion in cross-involvements	✓
35	Part 2	Expansion option requiring notification to Commission and ownership separation by 1 July 99	✓
36	Part 2	Compliance process for existing 20% aggregates	✓
38, 39, 40, 41, 42	Part 2	Rules and compliance options for mirror trusts and mirror co-operatives	✓
45	Part 2	Trusts that cease to be mirror trusts	✓
46	Part 2	No expansion of control by trust-like agencies in electricity supply (except where section 44 applies)	✓
68	Part 5	Duty not to defeat purposes of Parts 1 to 5	✓
80	Part 5	Extensions	✓
81	Part 5	Exemptions	✓
87	Part 5	Recommending regulations <sup>1</sup>	✓

<sup>1</sup> See the Practice Note section on *Recommending Regulations*.

Other Government agencies, including the Ministry of Commerce and the Inland Revenue Department, also have responsibilities in implementing and enforcing the EIR Act. For example, the Ministry of Commerce has responsibility for particular regulations, for implementation of the information disclosure regime, and for monitoring of involvements and interests.

## **ENFORCEMENT UNDER THE EIR ACT**

### **Nature and Scope of Enforcement**

The Commission has the power to bring proceedings under Part 3 of the EIR Act (enforcement and penalties) for contraventions of Part 2 or section 68 of the Act. In addition to the Commission, any other person can bring such proceedings.

Part 2 of the EIR Act sets out the ownership separation rules, as defined in sections 17, 18 and 20. The remaining sections of Part 2 are principally related to the ownership separation rules in that they provide:

- for certain businesses or involvements or interests in businesses not to be taken account of for the purposes of the EIR Act (section 19);
- a process for compliance with the ownership separation rules (sections 22 to 26 and section 36);
- for interim exemptions, rules and compliance options in respect of the ownership separation rules (sections 27 to 35);
- for “a mirror trust option”, which is a permanent exemption from the ownership separation rules in respect of mirror trusts and mirror co-operatives (sections 37 to 45); and
- for no expansion of control by trust-like agencies in electricity supply (section 46), except where section 44 applies.

Section 68 provides that no person may at any time do anything to defeat the purposes of Parts 1 to 5 of the EIR Act.

### **Enforcement Policy and Process**

The Commission will perform its enforcement role in respect of potential or alleged contraventions of Part 2 or section 68 of the EIR Act by adopting an enforcement approach which will primarily rely on:

- complaints, enquiries and market intelligence provided to the Commission; and

- an expanded role for the current business acquisitions surveillance programme being maintained for the Commerce Act.<sup>2</sup>

The Commission will have regard to the purpose of the EIR Act as defined in section 2(1) of the Act and will have specific regard to the particular purpose of Parts 1 to 5 of the EIR Act as defined in section 2(2).

In accordance with section 14 of the EIR Act, any question under Parts 1 to 5 of the EIR Act will be determined by the Commission according to the nature, substance, and economic effect of the interest or relationship or other facts, and independently of form.

The Commission will approach enforcement under the EIR Act using similar criteria and processes to those relating to the Commerce Act. The Commission will seek to employ the remedies provided in the EIR Act in response to specific competition issues which are identified as a result of the Commission's investigations.

The Commission notes that the EIR Act provides for maximum cross-ownership limits and specific structural and behavioural requirements to ensure that the purposes of the Act are met. Strict compliance with these limits and requirements is, other than in exceptional circumstances,<sup>3</sup> expected.

### *Complaints and Enquiries*

It is expected that complaints, enquiries and market intelligence received by the Commission are likely to provide effective and timely sources of information upon which to base any investigations under the EIR Act. However, the Commission may from time to time consider it necessary to take a priority approach to its enforcement role by selecting particular areas in which to promote further compliance with the EIR Act. Generally such priorities are aimed at changing the behaviour of multiple persons in the most effective manner.

All complaints and enquiries that come to the Commission's attention will be considered against 'investigation criteria' which will be used as the basis for selecting matters for investigation. In order to be investigated, a matter should ordinarily come within at least one of the following criteria:

- *Major market problem*, which includes matters which involve:
  - conduct that may adversely affect a large proportion of consumers or organisations in a significant market;
  - a Commission priority issue; or
  - industry practice.
- *Blatant disregard for the law*, which includes matters where:
  - there is prima facie evidence of a deliberate contravention;
  - there has been previous enforcement action against the person or organisation;
  - there is an ongoing course of conduct; or

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<sup>2</sup> As part of its Commerce Act enforcement role, the Commission maintains a business acquisitions surveillance programme which detects and monitors business acquisitions which are proposed, or which have been given effect to, and which have not been the subject of clearance or authorisation notices in accordance with the Commerce Act adjudication process.

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

- a court precedent has been ignored.
- *Precedent*, which includes matters where successful legal action could result in:
  - establishing a legal precedent;
  - clarifying a legal precedent;
  - extending a legal precedent; or
  - changing a legal precedent.

Once it has been decided that a matter falls within one or more of the above criteria it is necessary to decide whether the Commission will investigate the matter. The factors to be considered at this point are:

- whether a statutory defence exists;<sup>4</sup>
- whether the matter would be more appropriately dealt with by private action;
- whether the Commission can deal with the matter practically and efficiently through enforcement action; and
- whether the likely outcome would justify investigation.

In respect of its investigation process, the Commission has the same powers under the EIR Act as provided under the Commerce Act.

Once a matter has been investigated, the likely outcome is considered together with ‘enforcement criteria’ to ensure best use is made of the Commission’s available resources.

The enforcement criteria include:

- the strength of the available evidence;
- the extent and significance of the impact of the contravention;
- the expected knowledge of the relevant persons;
- the size, standing, and market power of the relevant persons;
- the seriousness of the effect on relevant persons;
- the impact that enforcement action would have on the competitive situation;
- corrective action by offending person(s);
- a conscious and deliberate contravention;
- industry-wide contraventions (or similar contraventions);
- disregard for Commission policy statements;
- precedent value; and
- significant educational or deterrent effect.

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<sup>4</sup> Sections 26, 44, 45(3) and 48 of the EIR Act provide potential statutory defences.

There are three main outcomes where enforcement action may be taken – a warning, an administrative settlement and court action.

### Warning

A warning informs the person that the conduct in question is at risk of contravening the EIR Act. A warning may be publicised. The aim of a warning is to persuade the person or company to change their conduct. A warning may be issued if there is evidence of a contravention of the EIR Act having occurred and:

- it is an isolated incident; and
- the contravention is not significant enough to require an administrative settlement or court action.

### Administrative Settlement

An administrative settlement may be entered into if:

- there is sufficient evidence to show that the EIR Act has been contravened;
- a real change in the person's conduct can be effected; and
- a better outcome in the particular instance can be achieved through settlement than court action.

An administrative settlement involves the person signing an undertaking to alter the conduct in question so that it no longer risks contravening the EIR Act. The undertaking may also cover such matters as:

- changes to governance procedures;
- introduction of a compliance programme;
- admitting contravening the EIR Act.

All administrative settlements are publicised by the Commission, either by means of a press release or in an article in the Commission's newsletter, "Fair's Fair".

### Court Action

Court action is likely to be undertaken where:

- a precedent is sought;
- a person has contravened the EIR Act despite a previous warning or administrative settlement;
- there has been a conscious and deliberate contravention of the EIR Act;
- there is real detriment to competition; or
- a person has refused to enter into a settlement.

## *Surveillance Programme*

The expanded role of the Commerce Act division's business acquisitions surveillance programme will involve the following Part 2 matters:

- monitoring cross-ownerships which might contravene sections 17, 18, or 20 of the EIR Act;
- monitoring expansions involving electricity businesses to detect any expansions in cross-involvements which might contravene section 30 of the EIR Act; and
- receiving notifications from persons who are exercising the expansion option under section 35 of the EIR Act.<sup>5</sup>

## **Timing of the Application of the EIR Act to Enforcement Matters**

In respect of the Commission's enforcement role, sections 37 to 45 (mirror trusts), section 46 (no expansion of control by trust-like agencies in electricity supply), Part 3 (enforcement and penalties), and section 68 (duty not to defeat the purposes of the EIR Act) are all deemed to have come into force on 21 May 1998. The Part 2 ownership separation provisions are deemed to have come into force on 23 June 1998.

## **Other Matters to Consider in Relation to Enforcement of the EIR Act**

### *Enforcement Proceedings (Section 57)*

In respect of the Commission's role of bringing proceedings under Part 3 of the EIR Act, the following three provisions in section 57 are particularly relevant:

- the standard of proof in proceedings under Part 3 is the standard of proof applying in civil proceedings;
- proceedings under Part 3 may be commenced within three years after the matter giving rise to the contravention arose.

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<sup>5</sup> Section 35 provides one option for expansion of cross-involvements and compliance with the ownership separation rules. This is the least restrictive option under the EIR Act in respect of expanding a cross-involvement, but imposes higher conditions than other options on any person to whom the option applies. An exempt person (in relation to section 35) must notify the Commission, as soon as practicable after first acquiring or increasing the level of an involvement, that the person is exercising the option under section 35.

*Relevant Commerce Act 1986 Provisions (Section 58)*

Section 58 of the EIR Act imports a number of provisions from the Commerce Act which are relevant to enforcement and penalties under Part 3 of the EIR Act. In respect of the

Section	Provision
98	Commission may require a person to supply information or documents or give evidence
98A to 98G	Search warrants
99	Powers of Commission to take evidence
100	Powers of Commission to prohibit disclosure of information, documents, and evidence
100A	Commission may state case for opinion of High Court
101 and 102	Form and service of Commission notices
103	Certain behaviour or conduct deemed to be offences
106	Commission's proceedings privileged

Commission's investigation and enforcement role for Part 2 or section 68 of the EIR Act, the following provisions of the Commerce Act particularly apply with necessary modifications:

## ADJUDICATION UNDER THE EIR ACT

### Nature and Scope of Adjudication

The Commission's adjudication role under the EIR Act relates to it considering and adjudicating on matters under sections 80 and 81 of the Act.<sup>6</sup>

#### *Section 80 (Extensions)*

Section 80(1) provides that "The Commission may, for the purposes of (the) Act, in its discretion, by notice in the *Gazette*, bring within (the) Act a business or involvement or interest that is disregarded under section 19". The Commission:

- may exercise that power by designating a business or involvement or interest as one to which a paragraph of section 19 no longer applies;
- is not authorised to make a class designation;<sup>6</sup>
- must, before making a designation, do everything reasonably possible on its part to advise the person whose business or involvement or interest is being designated of the proposed terms of that designation and give that person a reasonable opportunity to make submissions to the Commission. However, the requirements do not apply in respect of a designation if the Commission considers that it is desirable in the public interest that the designation be made urgently. In addition, failure by the Commission to comply with the requirements does not affect the validity of a designation;
- may vary or revoke any designation it makes in the same manner as that provided for by section 80 for making designations; and
- must keep a list of all current designations made by it under section 80, and make it available for public inspection free of charge during normal office hours at the offices of the Commission.

A designation under section 80:

- takes effect from the date specified in the designation (which may not be earlier than the date of the *Gazette* notice);
- has effect according to its tenor; and
- is not a regulation within the meaning of the Regulations (Disallowance) Act 1989.

#### *Section 81 (Exemptions)*

Section 81(1) provides that "The Commission may, for the purposes of [the] Act, in its discretion and upon such terms and conditions (if any) as it thinks fit, by notice in the *Gazette*, exempt any business or involvement or interest from the application of [the] Act, or exempt any person from compliance with any provisions of any regulations made under [the] Act". Under section 81:

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<sup>6</sup> Also see the Practice Note section on *Recommending Regulations*.

- the Commission is not authorised to make a class exemption;<sup>6</sup>
- the exemption takes effect from the date specified in the exemption (which may not be earlier than the date of the *Gazette* notice);
- the exemption has effect according to its tenor;
- the Commission may vary or revoke any such exemption in the same manner as that provided in section 81 for granting an exemption;
- the Commission must keep a list of all current exemptions made by it under section 81 available for public inspection free of charge during normal office hours at the offices of the Commission;
- an exemption under section 81 is not a regulation within the meaning of the Regulation (Disallowance) Act 1989.

Pursuant to section 81(1), the Commission may do either of two things:

- exempt any business or involvement or interest from the application of the EIR Act; or
- exempt any person from compliance with any provisions of any regulations made under the EIR Act.

Regulations can be made under the EIR Act:

- through section 87(1), by the Governor-General on the recommendation of the Commission for the purposes of effectively giving class extensions and exemptions;
- through section 87(2), by the Governor-General for certain purposes set out in that section;
- through section 88, by the Governor-General imposing price restraint in respect of charges relating to line function services to domestic premises and to consumers in sparsely populated areas.

### *Recommending Regulations*

Section 87(1) of the EIR Act enables the Commission to make recommendations to the Governor-General that the Governor-General, by Order in Council, make regulations for all or any of the following purposes:

- declaring a class of businesses or involvements or interests to be a disregarded business or involvement or interest to which the EIR Act does not apply for the purpose of section 19(1)(i) of the EIR Act, and specifying any conditions that apply;
- declaring a class of businesses or involvements or interests to be businesses or involvements or interests that are no longer disregarded for the purposes of the EIR Act under section 19.

### **Adjudication Policy and Process – Section 80**

The Commission considers that it is unlikely it will often be required to designate an extension of the EIR Act, in accordance with section 80, to a business or involvement or interest that is disregarded under section 19 of the Act.

However, in the event that the Commission is required to consider a section 80 extension, it will, having regard to the general purpose of the EIR Act as set out in section 2(1), obtain and evaluate objective answers to the following questions in relation to the particular purpose of Parts 1 to 5 of the EIR Act:

- Would the Commission, by not bringing within the EIR Act a business or involvement or interest, create incentives or opportunities to inhibit competition in the electricity industry?
- Would the Commission, by not bringing within the EIR Act a business or involvement or interest, create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses?
- Would the Commission permit, by not bringing within the EIR Act 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 addition, the Commission will examine the reason(s) why a business or involvement or interest was originally disregarded under section 19 of the EIR Act.

In relation to these questions, the Commission will consider factors such as:

- The relevant market(s)<sup>7</sup> 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.

### **Adjudication Policy and Process – Section 81**

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

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

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

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<sup>7</sup> Defined using the same process as used for market definitions in respect of Commerce Act matters.

- (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.

As noted, the EIR Act provides for maximum cross-ownership limits and specific structural and behavioural requirements to ensure that the purposes of the Act are met. Strict compliance with these limits and requirements is, other than in exceptional circumstances,<sup>8</sup> expected.

The adjudication process in respect of a section 81 matter will involve the Commission receiving an application for an exemption of a business or involvement or interest from the application of the EIR Act or from compliance with any provisions of any regulations made under the Act.

On receipt of an application in the prescribed form, the Commission will determine whether granting an exemption would be contrary to any element of the particular purpose of Parts 1 to 5 of the EIR Act or the overall purpose of the Act.

The Commission's test would necessitate obtaining and evaluating objective answers to the following questions in relation to the particular purpose of Parts 1 to 5 of the Act:

- Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to inhibit competition in the electricity industry?
- Would the Commission, by granting an exemption in respect of a business or involvement or interest, create incentives or opportunities to cross-subsidise generation activities from electricity lines businesses?
- Would the Commission permit, by granting an exemption in respect of a business or involvement or interest, a relationship between an electricity lines business and an electricity supply business which is not at arms length?

In relation to these questions, the Commission will consider factors such as:

- The relevant market(s)<sup>9</sup> 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.

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<sup>8</sup> For example, of the types provided for in section 19 of the EIR Act.

<sup>9</sup> Defined using the same process as used for market definitions in respect of Commerce Act matters.

## **OTHER PROCESSES**

### **Prescribed Forms**

In respect of the Commission carrying out its responsibilities under the EIR Act, section 58(r) imports into the EIR Act section 109 of the Commerce Act. Section 109 provides that for the purposes of the Commerce Act the Commission may from time to time prescribe forms of applications, notices, and other documents required for the purposes of the Commerce Act.

In addition, the Governor-General may from time to time, by Order in Council, make regulations:

- prescribing the procedure to be followed under the EIR Act in respect of applications and notices to, and proceedings of, the Commission (section 87(2)(i));
- prescribing forms of applications, notices, and other documents required for the purposes of the EIR Act, and requiring the use of such forms (section 87(2)(j)); and
- providing for such other matters as are contemplated by or are necessary for giving full effect to the EIR Act and for its due administration (section 87(2)(l)).

The Commission has developed a standard application form for the purpose of exemptions under section 81 of the EIR Act. The prescribed form is available from the Commission on request.

### **Section 81 Adjudication Fee**

Pursuant to the Electricity Industry Reform Act (Fees) Regulations 1998, a fee of \$11,250 (inclusive of Goods and Services Tax), is payable to the Commission by any applicant for an exemption under section 81(1) of the EIR Act.

In addition, the Regulations provide that the Commission must make a refund to an applicant who has paid the above fees where the actual cost of processing the application and refund is materially less than the fee paid.

### **Commission Registers**

The Commission will keep and maintain the following master registers at its Wellington office:

- a list of persons who are exercising the option for expansion of cross-involvements and compliance with the ownership separation rules under section 35 of the EIR Act;
- a list of all current designations made by the Commission under section 80 of the EIR Act available for public inspection free of charge during normal office hours at the offices of the Commission; and

- a list of all current exemptions made by the Commission under section 81 of the EIR Act available for public inspection free of charge during normal office hours at the offices of the Commission.

The Commission will maintain a copy of the registers for current extension designations and exemptions on its internet web site which will also be able to be accessed at the Commission's regional offices.

## **Publication of Commission Decisions**

Decisions by the Commission in relation to extensions (section 80) and exemptions (section 81) will be published, with appropriate confidential material deleted, on the Commission's website as soon as practicable after any such decision is released.

## **GENERAL MATTERS**

### **Application of the Commerce Act**

The Commission notes that:

- section 82 of the EIR Act provides that, with the exception of section 83 of the EIR Act, nothing in the EIR Act overrides or limits the provisions of the Commerce Act;
- section 83 of the EIR Act provides that for the purposes of Part II of the Commerce Act, an electricity lines business and an electricity supply business that do not have ownership separation are deemed to be separate bodies corporate that are not interconnected, despite the fact that they may have a common owner.

Section 83 gives wider effect to the Commerce Act in respect of contracts, arrangements or understandings between electricity lines businesses and electricity supply businesses than would otherwise be the case because of section 44 of the Commerce Act.

#### *Note*

Exemptions under section 81 of the EIR Act do not provide clearance or authorisation, as defined by the Commerce Act, for the exempted business or involvement or interest. There may be some circumstances where applications under both Acts will be required.

### **Official Information Act and Confidentiality**

The Commission is subject to the Official Information Act 1982. Therefore any information provided to the Commission is liable to be released on request unless there is reason to withhold such information under the Official Information Act. This applies to information provided to the Commission by persons giving notification under section 35 and seeking an extension or exemption under sections 80 and 81 of the EIR Act respectively. However, in addition to the reasons provided in the Official Information Act under which information may be withheld, the EIR Act imports section 100 (powers of Commission to prohibit disclosure of information, documents, and evidence) of the Commerce Act. Under section 100, the

Commission is able to protect information temporarily by making confidentiality orders in terms of that section.

Any material provided or submitted to the Commission in respect of the EIR Act for which confidentiality is sought should be clearly marked and annotated with the Applicant's grounds for confidentiality.

### **Offence to Deceive or Mislead the Commission**

Pursuant to section 58(m) of the EIR Act, section 103 (offences) of the Commerce Act is applicable to the EIR Act. Under section 103 of the Commerce Act, no person shall attempt to deceive or knowingly mislead the Commission in relation to any matter before it, and any person who does so is liable on summary conviction to a fine of up to \$10,000 for an individual, or up to \$30,000 for a body corporate.