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COMMERCE COMMISSION

DECISION NO. 317

Determination pursuant to the Commerce Act 1986, in the matter of an application for clearance of a business acquisition involving:

MERCURY ENERGY LIMITED

and

POWER NEW ZEALAND LIMITED

The Commission:	T G Stapleton (Chairman of Division) K M Brown E C A Harrison
Commission Staff:	Jo Bransgrove Andrew Brice David Ainsworth
Summary of Proposed Acquisition:	The acquisition by Mercury Energy Ltd of 100% of all of the shares in Power New Zealand Ltd.
Working Day 10:	25 February 1998
Working Day 12:	27 February 1998 (as the result of a two day extension of time agreed between the Commission and Mercury Energy Ltd).
Determination:	Pursuant to s 66(3)(a) of the Commerce Act 1986, the Commission determines to give a clearance for the proposed acquisition.
Date of Determination:	26 February 1998

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS

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THE ACQUISITION

1 Mercury Energy Ltd (Mercury) has given notice in terms of section 66(1) of the Commerce Act 1986 (the Act) seeking clearance to acquire 100% of all of the shares in Power New Zealand Ltd (PNZ).

2 Mercury has a clearance until 3 March 1998 (in terms of section 66(5)(b) of the Act) to acquire up to 100% of the shares in PNZ. That is because the date of the decision of the Court of Appeal, declining PNZ's appeal against the Commission's December 1994 decision to grant Mercury clearance to acquire PNZ, was 3 March 1997.

3 Mercury and UtiliCorp NZ Incorporated (UtiliCorp) together, also hold a clearance, Decision 299, for the formation of a joint venture company named "Holdco" to acquire up to 100% of the total number of shares in PNZ[1]. That clearance expires on 27 June 1998.

4 It was intended that Holdco would be owned in equal shares by Mercury and UtiliCorp and would hold a controlling interest in PNZ and its subsidiary, Bay of Plenty Electricity Ltd (BOPE). The Holdco joint venture would also have allowed Mercury and UtiliCorp to control WEL Energy Group Ltd (WEL) as a result of the aggregated shareholdings of UtiliCorp, Mercury and PNZ in WEL.

5 Mercury has advised that as a result of:

- [

  ];
- [ ]
- [

  ];

Mercury has decided it does not wish to enter into the Holdco joint venture. It has formally notified UtiliCorp of that decision.

6 It is the Commission's view and practice that business acquisitions must be examined within the context of current clearances granted by the Commission. As the Holdco clearance is still current, it will be necessary to consider the acquisition in the same way as the Commission considered the Holdco joint venture and having regard to any relevant changes and developments since that consideration, notwithstanding Mercury's decision that it does not wish to enter the Holdco joint venture.

7 [

]

THE PARTIES

Mercury Energy Ltd

8 Mercury is a large power company which generates, distributes and retails electricity. Its electrical network covers the areas of Auckland and Manukau Cities, and an area

of the Papakura District extending east of Manukau City to the Firth of Thames. The area of its network is shown on the map in Appendix One.

9 Mercury is a public company which is not listed on the Stock Exchange. At present all of Mercury's share capital is owned by the Auckland Energy Consumer Trust. It is Mercury's intention, in terms of its establishment plan, to issue 100 million one dollar shares [ ] The share issue will represent one quarter of the capital of Mercury.

10 Mercury has about 250,000 electricity customers. For the year ended 31 March 1997 it had electricity sales of $529 million. Mercury's total volume of electricity sold in that year to consumers connected to its own network was about 4,500 gigawatt-hours.

11 Mercury's subsidiaries and electricity generation joint ventures with other parties are shown in appendices 1A and 1B respectively. An additional joint venture with Transfield Ltd is referred to in paragraph 41.

12 Mercury, with joint venture partners, generates electricity from five power stations. A sixth is under construction. Details (actual and potential) are shown in Appendix Two to this report. Both of Mercury's larger power stations are connected to Trans Power's network.

13 Mercury is one of the major off-network electricity retailers in New Zealand. Its off-network sales for the year ended 31 March 1997 were about [ ] gigawatt-hours.

UtiliCorp NZ Incorporated

14 UtiliCorp is incorporated in Delaware, USA but is registered in New Zealand as an overseas company[2]. The ultimate parent, UtiliCorp United Incorporated (also USA based) is an electricity and natural gas distributor in various states in the USA.

15 UtiliCorp United Incorporated has investments in the United Kingdom, Australia and Jamaica as well as in New Zealand.

16 UtiliCorp's two shareholders are UtiliCorp South Pacific Incorporated (79%) and Todd Electricity Ltd[3] (21%). Staff note that this latter shareholding appears to be part of The Todd Corporation's long term business strategy of energy investment in partnership with a large and experienced overseas company.

17 UtiliCorp's only two investments in New Zealand are those in PNZ and WEL discussed below.

Power New Zealand Ltd

18 PNZ is a large power company which generates, distributes and retails electricity in, and to the north and west of, Auckland City, and in the Thames Valley and Coromandel Peninsula regions. The areas of its network are shown on the maps in Appendix Three.

19 PNZ is a public company which is listed on the NZ Stock Exchange. Its main shareholders are:

Mercury	33.20%
Utilicorp	30.60%
Power NZ Shareholders' Society	10.70%
WEL	7.90%
Valley Power Territorial Authorities	11.00%
PNZ Executive Share Option Programmes	1.94%
Small shareholders	4.66%

20 PNZ holds 37.5% of the shares in Pacific Energy Ltd (Pacific Energy), an energy wholesaling company, which purchases electricity on behalf of its shareholders, other power companies and major electricity consumers.

21 PNZ has about 223,000 electricity customers. For the year ended 31 March 1997 it had electricity sales of $300 million. PNZ's total volume of electricity sold in that year to consumers connected to its own network was about [ ] gigawatt-hours.

22 PNZ's off-network sales for the year ended 31 March 1997 were [ ] gigawatt-hours.

23 PNZ is constructing a geothermal power station at Rotokawa, north of Taupo. Details (actual and potential) are shown in Appendix Two.

OTHER RELEVANT PARTIES

WEL Energy Group Ltd

24 WEL is a large power company which distributes and retails electricity in the central Waikato area including Hamilton, Ngaruawahia and Huntly. The area of its network is shown on the map in Appendix Four.

25 WEL is a public company which is not listed on the stock exchange. Its shareholders are:

WEL Energy Trust	42.9%
UtiliCorp[4]	33.3%
PNZ	9.7%
Wilmel Nominees Ltd	4.3%
Todd Electricity Securities Ltd	1.9%
Pohutukawa Nominees Ltd	less than 0.1%
Mercury	1.8%
Small public shareholders	6.1%

26 WEL has one subsidiary, a wholly owned technology company which develops software for the electrical supply industry. WEL owns 12.5% of the shares in Pacific Energy, purchased from PNZ in mid 1996.

27 WEL has 64,500 customers and annual sales for year ended June 1997 of about $100 million. Its volume of sales to consumers connected to its network for the same year was about [ ] gigawatt-hours.

28 WEL has no electricity generation capability.

29 WEL retails off-network to [ ].

Bay of Plenty Electricity Ltd

30 BOPE is a medium sized power company which generates, distributes and retails electricity to consumers in the Eastern Bay of Plenty including Whakatane, Opotiki and Kawerau. The area of its network is shown on the map in Appendix Five.

31 BOPE is a public company which is listed on the NZ Stock Exchange. Its shareholders are:

PNZ	52.3%
Bay of Plenty Electricity Consumer Trust	25.1%
NZCSD[5]	2.3%
Bay of Plenty Electricity employee share plan	1.0%
Small public shareholders	19.3%

32 BOPE owns two trading subsidiaries:

- Kapuni Energy Ltd, holding 50% of the shares in a joint venture with Natural Gas Corporation Ltd to build and operate a co-generation plant at Kapuni; and
- Manukau Power Ltd which operates a residential subdivision connected to Mercury's network.

33 Bay of Plenty Electricity has 22,000 consumers connected to its network. Its annual sales for 1996/97 were about $48 million. Its volume of sales to consumers connected to its network for that year was about [ ] gigawatt-hours.

34 Details of BOPE's current electricity generation capability and generation plans are shown in Appendix Two.

35 BOPE had an off-network sales volume of [ ] gigawatt-hours in the year ended 31 March 1997. However, it has recently merged its off-network sales operations with those of its major shareholder, PNZ.

EXAMINATION OF THE ACQUISITION

Natural Gas Issues

36 The acquisition relates to the electricity sector. Todd Electricity Ltd, a 21% shareholder in Utilicorp, is interconnected with Todd Petroleum Mining Company Ltd, which has gas production and wholesaling interests in South Taranaki. PNZ and Pacific Energy have a very minor role in gas retailing, supplying one industrial customer in the Auckland area. Mercury is not directly involved in the gas sector.

Thus the acquisition does not result in any aggregation in natural gas markets and there is no further consideration of natural gas markets in this report.

Previous Examinations

37 The Commission had an opportunity to examine the issues raised by the acquisition in the context of Mercury's November 1994 application for clearance to acquire, in effect, all of the shares in PNZ. The Commission's clearance of that application was subsequently upheld by the High Court and the Court of Appeal. Reference is made below to those two judgments.

38 As noted, the Commission considered and granted clearance in June 1997 to the Holdco joint venture to acquire up to 100% of the total number of shares in PNZ. That clearance expires on 27 June 1998. That application raised issues similar to the November 1994 application.

39 However, in the 1994 application, aggregation in the national retail market occurred as a result of Mercury's intention to completely merge with PNZ and the fact that Mercury/PNZ and EnergyDirect Corporation Ltd were, at that time, closely connected companies[6] . In the 1997 application, Mercury did not intend to merge with PNZ, which was to remain as a separate entity, and EnergyDirect Corporation Ltd was no longer closely connected to PNZ.

Parties Providing Information and Comment In Respect of the Acquisition

40 PNZ, UtiliCorp and WEL were contacted by staff. All three companies advised that they did not wish to make any submission to the Commission with respect to Mercury's application for clearance. BOPE advised that it had nothing to add to its submission in respect of the Holdco clearance application.

41 Commission staff interviewed and received information from Mercury which indicated that apart from:

- [ ]
- the formation of Transfield Utility Services Ltd, a contracting services joint venture between the Australian contracting firm Transfield Ltd and Mercury, in July 1997;
- [ ]; and
- [ ];

there had been no changes in the relevant markets since the Commission's examination of the Holdco clearance application.

42 In particular:

- there have been no cases of Mercury's network being bypassed either by PNZ or by consumers connecting directly to Trans Power's substations;
- the national retail market continues to be competitive as is evidenced by Mercury's loss of market share; and

- TrustPower Ltd (TrustPower) continues to be active in the reticulation of subdivisions connected to Mercury's electrical network.

43 The interviews conducted, and the information and submissions received, by Commission staff in the course of the Commission's examination of the Holdco clearance application are described in paragraphs 32 to 58 of the Commission's decision on that application (Decision 299). The Commission has considered all of that material and all relevant changes and developments in its examination of the current proposed acquisition.

BACKGROUND TO THE ELECTRICITY INDUSTRY

Electricity Industry Participants

Generators and Wholesalers

44 At present ECNZ, Contact and Mercury are New Zealand's largest generators. There are, however, many other small power stations owned by, and embedded in, the local networks of power companies.

45 Generators sell electricity at wholesale either by means of bilateral contracts with purchasers, or by the NZEM pool mechanism. Purchasers who buy through the wholesale market are retailers and large consumers. The Electricity Market Company Ltd (EMCO) administers the NZEM. EMCO is owned equally by Trans Power Ltd (Trans Power), ECNZ and ESANZ. ESANZ is the Electricity Supply Association of New Zealand, a body which represents the interests of the majority of power companies.

Long Distance Transmission

46 Trans Power is responsible for the long distance transmission of electricity in New Zealand.

Distributors

47 As at the date of this report, 38 power companies such as Mercury, PNZ, WEL and BOPE are distributors of electricity in New Zealand.

Retailers

48 Retailers are either the power companies' incumbent retailers who retail to consumers connected to the networks of each of the power companies or independent retailers who compete with incumbent retailers by using the power companies' networks. At present all independent retailers are either existing power companies or the joint venture vehicles of existing power companies and there are no retailers who are new to the industry.

Recent Reforms in the Electricity Industry

Chronology of the Reforms

49 The key reforms since the mid-1980s have been:

- the transfer of the Government's electricity generation and transmission business

from the Ministry of Energy to a newly created state owned enterprise, ECNZ in 1987;
- a requirement for all electricity supply authorities to set up as stand alone companies in 1993;
- the removal of statutory monopolies in the distribution and retailing of electricity in 1994;
- the separation of the Government-owned transmission business (Trans Power) from ECNZ in 1994;
- the creation of a new state owned generation company, Contact in 1996, including the acquisition by it of a significant proportion of the generation assets of ECNZ; and
- the creation of the wholesale electricity market which was considered by the Commission in Decisions 277 and 280 relating to certain aspects of the interim and final rules for NZEM.

Generation and Transmission

50 The split of the dominant electricity generator, ECNZ, into two competing state-owned enterprises occurred on 1 February 1996 when ECNZ sold various of its power stations, which comprised 28% of New Zealand's generating capacity, to the new generator, Contact. Further, ECNZ's rights and obligations in terms of:
- existing power station natural gas fuel contracts;
- the proposed new Taranaki power station natural gas supply contracts and Resource Management Act 1991 consents, and
- its interests in power station development sites,

were also transferred to Contact. Contact was established for the purpose of competing with ECNZ for the provision of electricity generation. In 1995, the Government decided that eight of ECNZ's smaller power stations would be available for sale to local power companies and/or Maori interests, to provide further competition. Currently only Mangahao Power Station has been sold. Ongoing discussion and debate about the future of electricity generators and generation continues.

51 The transmission grid which connects all major power stations and the substations which supply electricity to major customers and power companies is owned and operated by Trans Power. In July 1994 at the direction of the Government, Trans Power, which previously was a wholly owned subsidiary of ECNZ, was separated from ECNZ and now operates as an independent state owned enterprise. The purpose of this was to facilitate access by generators and purchasers to Trans Power's grid on fair and reasonable terms.

Distribution and Retailing

52 The Energy Companies Act 1992 addressed issues of the ownership of power companies. It required the corporatisation of the then electrical supply authorities. A diversity of ownership forms resulted and these are discussed below.

53 The Electricity Act 1992 (effective from 1 April 1993) and its associated Electricity (Information Disclosure) Regulations 1994 (effective from 11 November 1994) provide for:

- the removal of exclusive electricity supply franchise areas;
- the accounting separation (ring-fencing) of the distribution business and the retailing business within each company; and
- the introduction of an information disclosure regime which requires the compulsory public disclosure of certain annual financial and performance information pertaining to the power companies.

\54 The purpose of the reforms was to reduce impediments to competition in the core business areas of the power companies by removing legislated protection (i.e. the exclusive franchise areas) and separating those business areas with natural monopoly characteristics (i.e. the distribution businesses) from those that are potentially competitive (i.e. the retailing businesses).

Summary of the Components of the Electricity Industry

55 The production, delivery and sale of electricity to consumers involves five stages:

- the generation of electricity in power stations;
- the trading of electricity in the wholesale market;
- the transmission of electricity from power stations to regions of substantial electricity consumption via high voltage transmission lines;
- the distribution of electricity to groups of consumers via power lines and cables; and
- the retailing of electricity to consumers.

56 The components are described below.

Electricity Generation

57 New Zealand has a mixture of hydro-electric, wind powered, geothermal and natural gas and coal fired thermal power stations. ECNZ and Contact together have the capacity to generate 94% of electricity available for public supply in New Zealand. The balance is presently generated by smaller power stations, mostly owned by power companies.

58 Mercury, along with various joint venture partners, has commissioned several medium to large sized power stations . The feasibility of numerous other power generation schemes is being investigated by other parties.

59 ECNZ estimated at the time of Decision 280, that its then market share of 68% of electricity generated in New Zealand would fall to 58% in 1998. At that time, the other major generators would be Contact, Mercury and the joint venture[7] which owns the new power station nearing completion near Stratford in Taranaki.

The Wholesale Electricity Market

60 In October and November 1995, the High Court heard an appeal against the Commission's clearance for Mercury to acquire, in effect, all of the shares in PNZ. On 14 December 1995 the High Court delivered its decision, *Power New Zealand Ltd v Mercury Energy Ltd* (CL 48/94 Barker J. and Dr Maureen Brunt, 14/12/95, HC-Auckland) *(PNZ v Mercury)*, in which it dismissed the appeal. The Court noted that "the heralded wholesale market in electricity is of utmost importance, not only for its impact upon the wholesale price of electricity but also for its impact upon the character of competition in retail markets."

61 The trading of electricity at the wholesale level occurs as a result of:

- bilateral contracts between generators and individual electricity retailers and large consumers outside the pooling arrangements discussed below; and
- spot trading of electricity on the NZEM. The electricity pooling mechanism which is inherent in this market involves generators offering to sell to any market participants certain quantities of electricity at certain prices from each of their power stations for each half hour of the year. This offer process establishes a merit order of generation plant. A merit order is a list of power stations running from lowest cost to highest cost for the electricity output of each. The merit order is used to establish which power stations are used to meet demand for electricity by dispatching electricity from power stations in the order of lowest cost to highest cost until a point is reached when one power station supplies the marginal electricity demand. The spot price for electricity is determined by the offered sale price of electricity from the power station which supplies the marginal electricity demand.

62 Bilateral contracting for the sale of electricity has been the norm for the many years when ECNZ and its antecedents were the dominant generators. The NZEM commenced operation on 1 October 1996.

63 The rules of the NZEM were voted into place by the market participants with each participant's voting right dependent on its market share. Market participants are generators, power company purchasers, retailers who are independent of power companies, electricity buying groups and major consumers. There have been rule changes since 1 October 1996. Ongoing discussion and debate among the participants about the market rules and the need for further changes to them continues.

The Transmission of Electricity

64 Electricity is transmitted throughout the country by high capacity, high voltage[8], inter-linked transmission lines owned by Trans Power. Trans Power is a state owned enterprise which owns and operates the national transmission line network and associated substations. Trans Power's customers are the major electricity generators and wholesalers on the one hand, and power company and major industrial electricity[9] purchasers on the other.

65 Trans Power's substations are the points of connection between Trans Power's high voltage transmission line network and the lower voltage distribution networks of the power companies. Part of the equipment in Trans Power's substations are transformers which reduce the voltage from the high voltages used for the long distance transmission of electricity to the lower voltages which are more appropriate for power companies to use for distribution of electricity to consumers. Trans Power's substations also contain the switches and isolators which are used to control the operation of transmission lines, metering and protection equipment and busbars which may distribute electricity towards several different points of consumption from a single substation.

66 Typically, a power company will use several Trans Power substations to supply it with electricity.

67 The Trans Power networks in the North and South Islands are connected by the High Voltage Direct Current Link across Cook Strait. This link may transmit power in both directions, although the flow of electricity is generally south to north.

The Distribution of Electricity

68 Electricity is distributed locally from Trans Power's substations to consumers by the substations, low voltage, inter-linked power lines and underground cables of the power companies.

69 The electricity distribution function can be distinguished from the electricity retailing function. Retailing concerns the sale of electricity to consumers at their premises, farms or residences. Distribution concerns the operation and management of the lines, cables, transformers, switches and other physical equipment which is needed to cause electricity to flow from Trans Power's substations to those places where consumers use electricity.

70 New Zealand has 38 power companies of which Mercury, PNZ, WEL and BOPE are four. Twenty one of these are owned either by community or consumer trusts. Six are owned by territorial local authorities. Ten are owned by private shareholders or by a mixture of private, trust and local authority shareholders. One is owned by the Government. Power companies' customers are industrial, commercial and domestic consumers of electricity.

71 The distribution networks of the power companies operate at lower voltages than Trans Power's transmission line network and in smaller geographic areas. Electricity passes from the low voltage side of Trans Power's substations by power line or cable to the power companies' zone substations. The voltage of this kind of line or cable is typically either 110, 000 volts or 33,000 volts. A zone substation is a lower capacity, lower voltage version of a Trans Power substation. Its function is to supply electricity at 11,000 volts to a zone of the power companies' supply area. Once again the voltage is reduced by means of transformers and once again there will be a number of different 11,000 volt lines or cables leading off the substation busbar supplying electricity to consumers in the area surrounding the zone substation. Such lines or cables are known as feeders.

72 A high voltage customer buys electricity from its power company at 11,000 volts and then reduces it to lower working voltages using the customer's own substation transformers. High voltage consumers are large consumers.

73 A distribution substation reduces the 11,000 voltage to 400 volts (or 230 volts between phases) at which voltage electricity may be safely reticulated to smaller commercial and domestic consumers. A distribution substation may be located on a platform raised up single or dual power poles, or it may be located at ground level in a small cubicle.

74 Hence, a power company's distribution network is effectively three sub-networks operating at three different voltages (33,000, 11,000 and 400 volts) which are connected via zone and distribution substations. These sub-networks are arranged

such that one voltage level provides support to the others in the event of a fault.

75 Power company engineers add extra capacity to a power company's network in steps. Such an increase in capacity might be to cope with industrial or residential subdivision growth or the arrival of a large new consumer. It may require the capacity of each of the sub-networks to be enlarged. For example, a new industrial subdivision may require additional 400 volt and 11,000 volt cables or power lines and distribution substations to be installed between the subdivision and the zone substation supplying the area, along with an increase in the capacity of the zone substation's transformer capacity and the cables supplying the zone substation from Trans Power's substation. Eventually such growth in the demand for electricity will require a step addition to the capacity of the Trans Power substation.

76 The minute by minute operation of the power companies' electricity networks and electricity flows over those networks is carried out in control rooms which the power companies maintain. Power company staff ensure that the supply of electricity from Trans Power substations into the networks of the power companies constantly matches consumer demand, and that alternative routing of electricity to consumers occurs during the breakdown or removal from service for maintenance of power lines or cables or substation equipment belonging to the power companies.

Retailing of Electricity to Consumers

77 Electricity is retailed to consumers in New Zealand by power companies and independent retailers. The independent retailers include power companies such as Mercury and Southpower, which actively seek to supply consumers outside their own distribution network area. In addition, four companies were established jointly by a number of power company shareholders for the purpose of purchasing their electricity from the wholesale electricity market and, as well, carrying out competitive retailing. The number of those companies carrying out competitive retailing has now reduced to one. The reasons cited are the small profit margins now available from electricity retailing as a result of competition and the consequent need for economies of scale.

78 Power companies which own and operate distribution networks also have an incumbent electricity retail function taking electricity for sale to consumers over their own lines and cables. Independent retailers, however, must gain access to distribution networks which they do not own, in order to supply consumers with electricity. Such access must be obtained from a power company network owner against whose incumbent retailer the independent retailer intends to compete. Network access by independent retailers is governed by the restrictive trade practice provisions of the Act which renders refusal of access by a power company for anti-competitive purposes illegal.

79 Both types of retailer pay Trans Power for access to its transmission network to transmit electricity from power stations to its substations prior to distribution to consumers by power companies and sale by retailers. Both types of retailers purchase electricity at wholesale by the mechanisms described above.

80 Power companies have installed electrical load management equipment. The purpose of this equipment is to reduce the electricity consumption of the consumers connected to the power companies' networks at times of high loading on the power companies' own networks or at times when the wholesale spot market price is high, all with the aim of reducing the power companies' investment and energy purchase costs. The load management equipment functions by compulsory control of domestic water and space heating and signalling upcoming periods of high electricity prices to industrial consumers who then have the opportunity to voluntarily reduce consumption.

ANALYSIS METHODOLOGY

81 The Commission has developed the methodology it uses to consider power company business acquisitions during its consideration of a number of actual and proposed mergers between power companies. A list is attached in Appendix Six.

82 In *PNZ v Mercury*, the High Court found that none of PNZ's criticisms of the Commission's procedures or decision had been made out and confirmed the Commission's decision to grant a clearance to Mercury to acquire, in effect, all of the shares inPNZ. In the course of its judgment, the High Court suggested some refinements to the Commission's approach to enhance the analysis of industry and competition issues on power company mergers. Those refinements have been adopted in considering the present application and completing this report.

RELEVANT MARKETS

83 The Commission, in assessing mergers of power companies, has considered a number of related markets. Generally, the Commission concluded that there were:

- a national electricity generation and wholesaling market;
- a national electricity network contracting services market;
- a national market for the ownership and operation of new distribution networks;
- distinct geographic markets corresponding to the distribution networks of the merging parties for electricity distribution to all consumers and the retailing of electricity to small consumers; and
- a national market for the retailing of electricity to medium and large consumers.

84 In *PNZ v Mercury* the High Court emphasised the need for markets to be distinguished by reference to substitutability "as a matter of fact and commercial common sense". The High Court noted that if the basis for market definition is taken to be substitutability, then for the distribution function, each customer connection can be considered a separate market. The High Court concluded that the most useful market definition approach is to recognise that the merged firm's sphere of operations in the distribution function would expand. The High Court noted that the "source of the enlarged firm's market power in distribution is unchanged; it lies in the natural monopoly possessed by the ownership of the local distribution lines and their dependence upon the nearest transformer. But the geographical scope of its exercise would expand. Its pricing and services would be coordinated." The High Court noted that the constraints on the merged entity should be assessed by reference to those new enlarged boundaries.

85 The competition question is, therefore, whether the merged entity would be less constrained than the participant power companies would be without the proposed merger.

86 In respect of markets relating to new networks, the High Court concluded that there is a national market for the construction of such networks. However, operation and ownership of new networks is, in the Court's view, a regionally defined activity that should be treated as a constraint on existing line services.

87 Additionally, the High Court believed that drawing a distinction between the distribution and retailing of electricity to small consumers was unnecessary, the relevant market is for the supply of delivered electricity to small consumers. Again the analysis should recognise that the merger would lead to the acquiring firm expanding its area of activities.

88 In summary, the High Court considered that the appropriate markets for the consideration of power company mergers are:

- a national market for the wholesaling of electricity;
- a national market for the transmission of electricity;
- a national market for the construction of new networks;
- prior to the merger, two local distribution markets to medium and large consumers corresponding to the electrical networks of the merging companies and, following the merger, one distribution market comprising the merged entity's electrical networks;
- prior to the merger, two local markets for the supply of delivered electricity to small consumers and, after the merger, one such market; and
- a national market for the retailing of electricity to medium and large consumers.

In tabular form, these electricity markets can be represented as follows:

Table of Relevant Electricity Markets

Functional Level	**Geographical Level**	**Consumption Level**
Wholesaling	National	All levels
Transmission	National	All levels
Construction of new networks	National	All levels
Distribution	Local/regional	Medium and large
Distribution and retailing (delivered electricity)	Local/regional	Small
Retailing	National	Medium and large

89 The High Court's conclusions in *PNZ v Mercury* were subsequently upheld by a five member bench of the Court of Appeal. The Court of Appeal addressed the High Court's view that it was necessary to assess potential bypass competition in markets which corresponded with the merged firm's enlarged distribution area. It considered that this approach was appropriate in the circumstances of the case. It noted, however, that the expanded market area is not a new field of transactions, but rather is a "new market description". The result is that the correct specification of the

dominance issue is whether existing dominance is strengthened, rather than whether new dominance is acquired.[10]

90 The Court of Appeal also upheld the views of the High Court and the Commission that there was not a discrete regional market for retailing electricity to medium sized commercial consumers.

The Post Acquisition Entity

91 As noted, because the Holdco clearance is still current, the post acquisition analysis of the present acquisition must be considered in terms of the post acquisition entity in that clearance. Such analysis necessarily includes the post acquisition analysis of the present acquisition.

92 Holdco would be interconnected, in terms of s 2 (7) of the Act, with PNZ (having control of at least 64% of the shares of PNZ) and BOPE (having control of about 53% of the shares of BOPE). Both Mercury and Utilicorp would be considered to be associated with Holdco in terms of s 47(3) of the Act, as, being 50/50 joint venture partners, each would be able to exert a substantial degree of influence over Holdco. Utilicorp already directly holds 39.6% of the shares in WEL, and has the right to appoint two directors to its board. Utilicorp and WEL would, therefore, be considered to be associated. Mercury, Utilicorp and PNZ together control about 51% of the shares in WEL. A diagram showing the ownership interlinkages of Holdco is attached as Appendix Seven.

93 There are a number of agreements involving the various parties, as described below:

- a cornerstone relationship deed between Utilicorp and PNZ, recording the relationship between the two parties and noting UtiliCorp's wish to become the long term cornerstone investor in PNZ[11] ;
- a cornerstone agreement between Waikato Electricity Authority[12] , WEL and Utilicorp in respect of WEL shares; and
- a shareholders agreement between PNZ and the Bay of Plenty Electricity Consumer Trust concerning the strategic development of BOPE.

94 Given the intertwined shareholdings involving Utilicorp and Mercury individually, and jointly through Holdco, staff consider that, for the purpose of analysing aggregation in the relevant markets, Mercury, PNZ, WEL and BOPE should be considered as one unit (the post acquisition entity).

95 Staff have considered whether Todd Electricity Ltd's (Todd's) interest in Utilicorp is sufficient to make it an associated person with Holdco. However, it is noted that Todd's only interest in the electricity sector is its 21% interest in Utilicorp (which would have a 50% shareholding in Holdco), and this is not likely to allow it to exert a substantial degree of influence over Holdco and thus be an associated person with Holdco.

Consideration of Relevant Electricity Markets

96 Of the electricity markets tabulated above, staff do not believe that the acquisition is likely to raise competition concerns in the markets for the transmission of electricity

and the construction of new networks. Staff note that there are a number of firms actively involved in the market for the construction of new networks and entry conditions do not appear to be onerous. Further, the acquisition is unlikely to have any impact in the transmission of electricity market.

97 The post acquisition entity (and its partners in generation projects) will, as is shown in Appendix Two, generate approximately [ ] gigawatt-hours per annum of electricity from various power stations which have a total capacity of approximately 390 megawatts. These figures may be compared with national annual generation of about 32,000 gigawatt-hours from about 8,000 megawatts.

98 Therefore, although there may be minor aggregation in generation, given the number of other substantial generators active in the wholesale electricity market, the acquisition is unlikely to have any anti-competitive impact in the wholesale electricity market.

ASSESSING COMPETITION ISSUES IN THE MARKETS

Introduction

99 Staff believe the following markets require further consideration:

- prior to the acquisition, five local markets for the supply of delivered electricity to small consumers and, after the acquisition, one such market;
- prior to the acquisition, five local distribution markets to medium and large consumers and, after the acquisition, one such market; and
- the national market for the retailing of electricity to medium and large consumers.

100 These markets are addressed in turn.

Markets for the Supply of Delivered Electricity to Small Consumers

101 The acquisition is unlikely to have any impact on the potential for the competitive supply of delivered electricity to small consumers. Currently, metering, reconciliation and other transaction costs preclude small consumers from being supplied by competing retailers “wheeling” electricity over distribution networks. Accordingly, small consumers are presently confined to purchasing delivered electricity from their distributor.

102 In this case, staff believe that the supply of delivered electricity from each power company to small consumers of the other power companies is unlikely to be feasible within the near future.

103 However, that said, the Commission has received information from the participants in two competitive trials whose purpose is an attempt to bring competition to the supply of electricity to small consumers. The two trials are:

- ORCA. This trial involves Southpower Ltd, Powerco Ltd and Mercury using an electronic platform connected to trial consumers’ electricity meters. Small consumers connected to the electricity networks of these power companies may receive competitive supply of electricity from each. The participation of other parties such as gas companies, banks and telephone companies in the trial is an attempt to allow economies of scale to assist with competitive electricity retailing; and

- deemed profile trial. This trial involves United Electricity Ltd, Southpower Ltd and TransAlta New Zealand Ltd. Its purpose is to reconcile the electricity consumptions of small consumers to their electricity supplier (any one of the three participants) at various times of the day and week using a deemed profile of their total electricity consumption rather than the actual profile. This is an attempt to reduce the transaction costs of reconciliation which is one of the barriers currently preventing the arrival of competition in the supply of electricity to small consumers.

104 In addition, the feasibility of using deemed consumption profiles to allocate the total electricity consumptions[13] of small consumers at different times of the day and on different days of the year is presently under close scrutiny by the Government and the electricity industry. Staff believe that given the slow introduction of competitive supply to larger consumers following removal of the statutory electricity franchises, the introduction of deemed profile competitive supply to small consumers on anything other than the above trial basis is still some years away. In any case, deemed consumption profiles appear to allow small consumers to become part of the national retail market, considered below.

105 Therefore, to the extent that Mercury, PNZ, WEL and BOPE are dominant in their respective electricity distribution areas for the supply of delivered electricity to small consumers, the acquisition would not result, and would not be likely to result, in any strengthening of dominance in the post acquisition market.

The Electricity Distribution Markets

106 The distribution of electricity is, prima facie, a natural monopoly. This is because, in most cases, it is not economically viable to duplicate existing electricity lines due to the sunk cost associated with the existing lines and scale economies derived from the network's operation.

107 Prior to the passing of the Electricity Act 1992, power companies enjoyed an exclusive franchise within a defined geographic area. The franchise area determined the technical design of the network. With the removal of exclusive franchise areas staff believe that, over time and in limited circumstances, power companies may connect formerly discrete networks and undertake some technical reconfiguration within networks to improve the quality of supply.

108 However, irrespective of whether or not distribution networks can be, or are likely to be, connected post acquisition, staff believe that the underlying characteristics of distributing electricity mean that distribution networks will not be duplicated except in very limited circumstances. There are very few occasions when any individual customer is able to substitute one network for another (discussed below as cross-border competition).

109 Consequently, each power company can generally be considered as having a monopoly over the distribution of electricity in the area covered by its distribution network.

110 Notwithstanding their natural monopoly characteristics, the distribution businesses of power companies are likely to face some constraints on their behaviour. Generally, these arise from:

- the ability for a customer close to the border between two distribution networks to connect to the adjacent network;
- the ability for a customer close to a Trans Power point of supply to arrange a direct line of supply;
- the Electricity (Information Disclosure) Regulations which require power companies to disclose information to assist in the monitoring of power companies and recourse to the provisions of the Act;
- potential government regulation of pricing by power companies;
- new networks (developments or sub-divisions) within the relevant distribution markets; and
- competition from other fuels.

111 Generally, mergers between power companies are, at present, likely to have only a minimal impact on a number of these constraints. The potential for large electricity consumers to connect directly to a Trans Power point of supply and the potential for government regulation of prices, where it is in the interest of consumers, remains.

112 However, as is the case with the acquisition, the merger of power companies with common borders requires closer examination. In such circumstances, the merger could remove or reduce the potential for cross-border competition. Additionally, the merger of power companies has the potential to lessen the effectiveness of the information disclosure regime by making yardstick comparisons more difficult to make. The effect of the acquisition on the information disclosure regime is discussed below. This report also considers the impact of the acquisition on the constraint imposed by new electrical networks.

113 As noted by the High Court and endorsed by the Court of Appeal in *PNZ v Mercury*, in considering the competitive effect of a proposal, the issue is whether the merged entity would be less constrained than the participant power companies would be without the proposed merger.

Potential for Cross-Border Competition in the Electricity Distribution Markets

114 The High Court in *PNZ v Mercury*, while agreeing with the relevant conclusions, noted that, if anything, Commission staff had taken the possibility of cross-border competition too seriously in that scenario.

115 Instead, the Court adopted the statements of counsel for Mercury and the Commission which led to two decisive points[14] :

- counsel for Mercury had noted that the "circumstances of this particular 'border' are about as unpropitious for potential 'cross-border' competition as any could be"; and
- counsel for the Commission had noted that scepticism is warranted as to the reality of cross-border competition between only two adjoining suppliers. The Court did not dismiss out of hand, the possibility of cross border competition in

such circumstances, but observed that "it would need to rest on evidence rather than assumption".

116 In adopting the *PNZ v Mercury* approach, staff note the following points[15], in addition to those made by the High Court, which reinforce a more sceptical view of the amount of cross-border competition which is likely to occur in reality:

- during the Commission's examination of the mergers listed in Appendix Six, staff found only three examples of electricity consumers near the companies' borders who had been able to negotiate lower line charges as a result of cross-border competition[16] In the same examinations, Commission staff learnt of only one actual cross-border incursion which had occurred, in the three years post-deregulation [17] ;
- the discounted cash flow return on investment approach previously used did not take into account the transaction costs necessary to obtain cross-border customers. In staff's view, the costs of negotiating the necessary long term supply contracts with "over-the-border" consumers would be substantial and would reduce the ability of adjacent power companies to offer lower line charges to over the border consumers;
- previous analyses, which confirmed the potential for cross-border competition for groups of medium sized consumers, relied on an assumption that all (or a very large proportion) of the grouped consumers would change supplier. In reality, staff consider this is unlikely. The small savings in the total costs of a business made possible by cross-border competition[18] when balanced against the necessity for the consumer to sign a long term contract (with the contingent liability and resultant inflexibility as regards the location of the consumer's plant) make a 100% "sign-up" rate improbable;
- in the Commission's experience, commercial consumers often place more emphasis on security of supply than lower line charges. It is possible that there may be reductions in security of supply to cross-border consumers as a result of their necessary connection by spur lines rather than by being enmeshed within a network. Staff believe reliability of supply concerns may also reduce the incentives for consumers to change from their traditional power company distributor; and
- the ability of a power company to use non-standard line charges in order to gain cross-border customers is limited by the statutory requirement for the power company to disclose such non-standard line contracts. Staff believe such disclosure could lead to price pressure on the power company from many of its customers. The power company's revenue base could be put at risk by the small gains obtainable from a few new cross-border customers.

117 There have been no factual incidents of cross-border competition between Mercury and PNZ in any area and staff are not aware of the prospect of any. Given the judgment of the High Court, staff conclude that there is no loss of constraint on the post acquisition entity, due to the removal of the potential for cross-border competition between Mercury and PNZ.

118 As to the possibility of loss of constraints on the post acquisition entity due to the reduction of the potential for cross-border competition between WEL and PNZ in the

Waikato/Thames valley area, such loss, if it existed, would have been due to the acquisition by UtiliCorp of large shareholdings in both PNZ and WEL[19] rather than the present acquisition.

119 A map showing the five local distribution markets of Mercury, PNZ, WEL and BOPE is attached as Appendix Eight.

120 An examination of the potential for cross-border competition between PNZ and WEL was carried out by staff in 1994 as part of the examination of an application for clearance by PNZ to acquire 100% of the shares in EnergyDirect Corporation Ltd. The PNZ/WEL border runs through forestry and agricultural land and there are no major consumers near to the border.

121 Given its sparsely populated rural nature, it is staff's view that the PNZ/WEL border is much less conducive to cross-border competition than the Mercury/PNZ border. If the Mercury/PNZ border was labelled by Mercury's counsel and accepted by the High Court as "unpropitious" with respect to the potential for cross-border competition, then the same must be so of the PNZ/WEL border.

122 BOPE's network is not contiguous with that of any other member of the post acquisition entity.

123 Therefore, staff conclude that the loss of potential cross-border competition (if any) resulting from the acquisition would not result in the removal of any significant constraints on the post acquisition entity and as such there would be no strengthening of dominance in the post acquisition distribution market.

Potential for Direct Connection to Trans Power Ltd

124 The potential for the direct connection of large consumers to Trans Power substations is a constraint on power companies which is, however, limited to the situation where a large consumer is located sufficiently close to a Trans Power substation for connection costs not to besignificant.

125 Staff have learnt of several instances where power company pricing has been constrained by the potential for such direct connection.[20] .

126 However, staff note that in *PNZ v Mercury*, the High Court thought it was right to conclude that the ability of large customers (or perhaps groups of medium sized customers) to connect directly with Trans Power was unaffected by the proposal.

127 Staff are not aware of any facts which would alter that conclusion in respect of the acquisition.

Potential for Yardstick Comparisons

128 The Electricity (Information Disclosure) Regulations 1994 provide for the disclosure of information intended to reveal anti-competitive behaviour, excessive rates of return, line and other charges and inefficient investment or performance.

129 The information disclosure regime is intended, in part, to facilitate yardstick comparisons of power companies' activities. Comparisons between similar power companies provide benchmarks against which a power company's activities can be measured. However, staff note that it has been difficult to make meaningful comparisons between power companies. The regulations allow a degree of differing interpretation by each power company in defining what makes up each business and how costs and assets should be allocated between the line and energy (or other) businesses of the power company. Discussion and debate about the regulations, and whether the difficulties experienced with them can be ameliorated by amendment, continues. However, the ability to make inter-company comparisons is also handicapped by the different size, customer mix, and geography of the power companies.

130 In this case, the acquisition will link the largest power company (Mercury) to the second, sixth and thirteenth largest power companies (PNZ, WEL and BOPE, which are already linked to each other). While, post-acquisition, each company will continue to be required to report separately for information disclosure purposes, it is possible that comparisons will be less meaningful as a result of the proposed greater level of common ownership. It is noted, however, that the comparisons lost will not be between similar types of companies. ESANZ, in its review of power companies, placed Mercury in the "Urban Group" category, while the other three companies are placed in the "Mainly Urban Group".

131 In any event, TransAlta and Southpower will provide some useful comparisons with the post acquisition entity.

132 In *PNZ v Mercury*, the Court considered it unnecessary to consider the extent to which the information disclosure regime provides a constraint on power companies. The Court concluded that the decisive point was that the elimination of PNZ would have very little effect upon the availability of comparative material, both within New Zealand and internationally.

133 Staff consider that the extent to which the power companies in question are constrained by the information disclosure requirements will be largely unaffected by the acquisition.

New Networks - Operation

134 The regulatory reforms outlined above, *inter alia*, removed exclusive franchise areas for power companies. The ownership and operation of the network in any particular area need no longer be undertaken by the incumbent distributor. In limited circumstances, line extensions from the core network have been owned in the past by private parties. For example, consumers have owned lines in rural areas and port companies and airports have owned and operated their own reticulation. However, it is now possible for network assets, such as substations and other reticulation in new subdivisions, to be owned by parties other than the incumbent distributor.

135 It is not necessary to obtain Electricity Operator status, in terms of the Electricity Act 1992, to operate a network. However, Electricity Operator status provides rights of access to land to complete works started prior to the reforms, access to the road reserve and access to railway crossings. Such access can be negotiated independently with the appropriate authority, without Electricity Operator status.It is likely to be necessary for the new network owner to provide some surety to the developer and local authority of its substance and longevity as a network operator. Staff note there are a number of power companies and contracting businesses with the requisite expertise to build and maintain network assets.

136 While each subdivision is site specific, there appears to be no reason why ownership of the networks should be geographically limited to the incumbent or neighbouring power companies. It is likely that a local presence is necessary to operate the network. However, staff believe that the actual ongoing maintenance and operation of the network can be undertaken by local subcontractors. At this stage, Mercury, Tauranga Electricity Ltd and TrustPower own network assets outside their established network areas.

137 In *PNZ v Mercury*, the High Court noted that the operation of new networks in the Auckland region was not confined to Mercury and PNZ and that the proposal would have little effect on the constraint imposed by new networks. As noted in paragraph 53 of Decision 299, although BOPE, a substantial developer of subdivisions, has been effectively removed from the Auckland market, TrustPower remains a significant competitor.

138 Competitive ownership and operation of new network assets is relatively new and it is difficult to determine fully how such competition will constrain the incumbent distributor. Nevertheless, to the extent that competitive ownership of new networks constrains the incumbent distributor, the acquisition is unlikely to lessen that constraint.

139 Accordingly, any constraint imposed by new electrical networks, while likely to be limited in this case, is unlikely to be lessened by the acquisition.

Conclusion on the Distribution Markets

140 Taking account of the analysis and conclusions in paragraphs 106 to 139, staff believe that the acquisition will not lessen the constraints imposed on the post acquisition entity in the post acquisition electricity distribution market relative to those currently imposed on Mercury, PNZ, WEL and BOPE in the distribution markets. Accordingly, in staff's view, the acquisition would not result, and would not be likely to result, in any strengthening of dominance in the post acquisition distribution market.

National Electricity Retail Market

141 The deregulation of the electricity industry resulted in, amongst other changes, the removal of statutory franchise areas for power companies. Consumers of electricity may, therefore, be supplied by a party other than the incumbent power company.

142 As noted above, staff believe that metering and reconciliation costs currently preclude small consumers from being supplied by competing retailers. Such consumers are,

therefore, confined to purchasing electricity from the incumbent retailer. However, metering and reconciliation costs form a relatively small part of the costs of supply to medium and large consumers and, generally, those consumers are believed to be able to use the services of competing retailers. The division between medium and large consumers for whom the competitive retail supply of electricity is possible and the others has been taken by the Commission to lie within the 0.1 GWh (medium sized school) to 0.5 GWh (fast food outlet or department store) per annum consumption range.

143 There are a number of power companies actively seeking retail customers outside traditional network areas. The National Reconciliation Manager[21] reported that in November 1997 12 independent retailers used its services for the reconciliation of off-network sales. This figure varies between 11 and 16 depending on who has contracts at any particular time.

144 In *PNZ v Mercury*, the High Court noted "the dynamic contribution that is being made by the off-network retailers (the "wheeling" retailers). The power companies are themselves directly involved in making forays into rival territories; and they are also indirectly involved in participating in joint trading ventures. There has been a remarkable growth in wheeling activity, as earlier described. The percentage of wheeled supply to the total supply of electricity to commercial and industrial users (excluding ECNZ's direct supply customers) on the most recent figures (July 1995) amounts to 13%"[22] .

145 Further, staff believe that there is the potential over time for non-incumbents to operate as retailers of electricity. Generally, entry conditions relate to:

- agreements to access distributors' networks;
- access to the wholesale electricity market;
- industry knowledge and technical expertise;
- commercial credibility with customers; and
- the cost of time-of-use metering.

Agreements to Access Distributors' Networks

146 In order to retail electricity, it is necessary to negotiate access to the relevant distribution network. Obtaining such access to some networks has, and continues to be, difficult.

147 Although a number of electricity retailers have off-network customers and the volume of off-network sales is significant (127 gigawatt-hours in November 1997), the previous increase in off-network sales by independent retailers appears to have levelled off and may be decreasing slightly[23] . Incumbent retailers may now more accurately understand that if they allow their margins over electricity purchase price to grow too large, their customers will be taken from them by off-network retailers. It is clear from statements made by every party interviewed by staff during the examination of the Holdco clearance application that electricity price margins for consumers in the national retail market are very low. During the examination of that application, Mercury provided staff with information which showed a continuing high level and on-going demand by off-network customers for quotations for electricity supply by Mercury.

148 However, notwithstanding the statements made to staff during the examination of the Holdco clearance application, the Commission is investigating, in terms of Part II of the Act, allegations that access to particular networks is being delayed or hindered.

149 In *PNZ v Mercury*, the High Court noted that "the most significant barrier to entry in retailing lies in the 'access problem'". The Court concluded, however, that "while complaints have been made to the Commission, access to distribution has not been an impediment to the development of the wheeling function".

Access to Wholesale Electricity Market

150 In this regard, the High Court noted that the "very development of the wholesale market will facilitate entry by independent traders and give a fillip to competition in the retail market". The recently formed NZEM, with its wholesale electricity pool, is playing an important role in this respect. Firms wishing to trade in NZEM must meet high prudential requirements and face transaction costs, and this has meant that some players, who would otherwise wish to participate, have been excluded (or forced to operate through buying groups). Staff note, however, that the wholesale market is wider than NZEM, and that those excluded from NZEM are not necessarily prevented from operating at the wholesale level.

Industry Knowledge and Technical Expertise

151 Staff note that there is a significant body of industry knowledge and technical expertise both within power companies and outside existing power companies in a multitude of consultants and major consumers. Staff believe that the requisite industry knowledge and technical expertise for entering the industry can be developed or acquired over time.

152 As noted by the High Court in *PNZ v Mercury*, the emergence of a competitive wholesale electricity market suggests that retailers will need to acquire or develop appropriate risk management skills and industry knowledge in order to trade in electricity. However, as the Court noted, these considerations point not so much to the existence of barriers to entry, as to the identity of those who may profitably enter. For example, in referring to the advantageous purchase terms secured by Mercury in recent years, the Court interpreted that fact as "demonstrative of Mercury's skills and competitive capacity, not its market power."

Commercial Credibility with Customers

153 In the short term, customers may stay with established power companies until they are more familiar with their ability to trade-off incumbent and new entrant retailers. To the extent that consumers are influenced by the features discussed above, new entrants may have to invest in marketing and advertising to become acceptable to some customers.

154 Staff note that there is little to suggest that branding or the development of commercial credibility is yet a significant factor in the electricity industry. For example:

- while customers may distinguish between retailers largely on the basis of price, they may also distinguish between distributors on the basis of security of supply;

- since the reforms were undertaken, almost all power companies have changed their name distancing the power company from historic supply authority associations; and
- the independent retailers associated with existing power companies have not considered it necessary to associate the name of the retailing arm with that of the parent power company(ies) (NETCO - Capital Power, Energy Brokers, Pacific Energy and United).

The Cost of Time-of-Use Metering

155 At this stage, access to suitable meters does not appear to have been a significant issue for new entrant retailers. However, the cost of time-of-use meters is high and currently prevents the competitive supply of electricity to small consumers.

Conclusion on the National Electricity Retail Market

156 It is noted that the post acquisition situation will not be markedly different from the situation in this market at the times of both the 1994 Mercury/PNZ clearance application and the Holdco clearance application. In *PNZ v Mercury*, the High Court noted in respect of the national electricity market:

> "...there is certainly no dominance in sight."

In reaching that conclusion, the High Court took into account power companies' sales (line plus energy dollar sales) and assessed the share held by the four companies with the highest sales figures pre and post merger[24] . The pre and post merger figures were both 52%. The equivalent figures in this case are 49.8% and 59.8% respectively.

157 On the basis of electricity retailer incomes[25] , as used by the High Court, the sales of the post acquisition entity will be about 36% of the total New Zealand wide electricity sales by power companies (see Appendix Nine).

158 There is no available published data which shows market shares of participants in the national retail market. However, *The New Zealand Electricity Sector, 1996-1997*[26] provides details of the volumes of sales by power companies to industrial and commercial consumers. Staff believe those sales closely approximate sales in the national retail market.

159 Staff's analysis of these figures shows that the sales volume attributable to the post acquisition entity is 39.7% of total sales volumes to the commercial and industrial sector (see Appendix Ten).

160 Staff note that this market share falls within the Commission's "safe harbour" of a 40% market share outlined in the *Business Acquisitions Guidelines.*

161 As noted above, there are a number of retailers actively seeking sales in the national retail market. The situation appears very dynamic with retailers entering and leaving the market. The level of competition is reflected in the small retail margins, and has meant that the less efficient companies have been unable to survive.

162 As discussed above, and as accepted by the High Court, entry barriers into the national retail market are not considered to be high. In reaching this conclusion, it is recognised that electricity retailing is becoming an increasingly sophisticated exercise. It is also recognised that access to networks can be difficult in some areas, although the High Court noted that, in general, it had not been an impediment to the development of the wheeling function. Again, as noted earlier, the Commission is investigating, in terms of Part II of the Act, allegations that access to particular networks is being delayed or hindered.

163 Notwithstanding Mercury's argument to the contrary in the examination of the Holdco clearance application, the acquisition will result in the removal of PNZ as a major competitor in the national retail market. However, there are still many other powerful players in this market. These include Southpower Ltd, United Electricity Ltd, TransAlta NZ Ltd, Powerco Ltd, TrustPower Ltd and potentially Contact and ECNZ. In addition, there are several other minor players who participate in this market.

164 Therefore, staff believe that, for the reasons discussed above, the acquisition would not result, and would not be likely to result, in the acquisition of a dominant position by the post acquisition entity in the national retail market.

CONCLUSION

165 Staff therefore believe that the conclusions reached in the examination of the Holdco clearance application as to relevant markets and the acquisition or strengthening of dominance therein, reconsidered in the light of relevant changes and developments in those markets since that examination in June 1997, are unchanged in respect of the acquisition and apply equally to it.

166 Staff conclude that they are satisfied that the implementation of the acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in any relevant market.

RECOMMENDATION

167 It is recommended that, in terms of section 66(3)(a) of the Act, the Commission give clearance to the acquisition.

________________	________________	________________
Investigator	Chief Investigator	Manager

DETERMINATION ON NOTICE OF CLEARANCE:

MERCURY ENERGY LIMITED/POWER NEW ZEALAND LIMITED

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66 (3) (a) of the Commerce Act 1986, we hereby give/decline to give clearance for the acquisition by Mercury Energy Ltd of 100% of all of the shares in Power New Zealand Ltd.

Dated this day of February 1998

T G Stapleton Member	K M Brown Member	E C A Harrison[27] Member

APPENDIX SIX

COMMISSION EXAMINATION OF POWER COMPANY BUSINESS ACQUISITIONS SINCE 1 APRIL 1993, AS AT 25 FEBRUARY 1998

Parties involved, dates of Commission decision and outcome of the acquisition are:

1 South Canterbury Power/Timaru Electricity (13 May 1993), merged
2 United Electricity/Dunedin Electricity, Electricity Invercargill (retailing businesses only) (29/10/93), merged
3 United Electricity/The Power Company (retailing businesses only) (18 January 1994), merged
4 United Electricity/Alpine Energy (retailing businesses only) (18 January 1994), merged
5 The Power Company/Electricity Invercargill (s 58 application to enter into a network management JV) (withdrawn 11 July 1994)
6 Bay of Plenty Electricity/Rotorua Electricity (15 August 1994), did not proceed, Rotorua Electricity subsequently sold to TrustPower
7 Trustpower/Rotorua Electricity (8 September 1994), merged
8 EnergyDirect Corporation/Capital Power (30 September 1994), did not proceed, relevant shares sold to TransAlta
9 Enerco/Capital Power (withdrawn 31 October 1994), did not proceed
10 Newco (Power New Zealand, EnergyDirect, WEL Energy Limited)/Capital Power (4 November 1994), did not proceed, relevant shares sold to TransAlta
11 Power New Zealand /EnergyDirect Corporation (25 November 1994), unable to proceed, unable to obtain EnergyDirect shareholder approval
12 Mercury Energy Limited/Power New Zealand (12 December 1994), still being pursued
13 Central Power/Wairarapa Electricity (26 May 1995), did not proceed, unable to obtain Wairarapa Electricity shareholder approval
14 Mergeco/Taranaki Energy, Powerco (26 May 1995), merged
15 Bay of Plenty Electricity/Taupo Electricity (18 August 1995), did not proceed, Taupo Electricity acquired by Trustpower
16 Hawkes Bay Power/Taupo Electricity (17 August 1995), did not proceed, Taupo Electricity subsequently acquired by Trustpower
17 Trustpower/Taupo Electricity (28 August 1995), merged
18 Power New Zealand/ Taupo Electricity (6 September 1995), did not proceed, Taupo Electricity subsequently acquired by Trustpower
19 EnergyDirect/Capital Power (7 February 1996), merged as TransAlta New Zealand Ltd
20 Marlborough Electric/Tasman Energy (28 March 1996), did not proceed
21 Marlborough Electric/Tasman Energy and Nelson Electricity Ltd (17 June 1996), acquisition has been completed
22 Powerco/Egmont Electricity,application withdrawn, authorisation subsequently granted, merged
23 CentralPower/Electro Power (14 November 1996), merged
24 Mercury/UtiliCorp/Holdco (27 June 1997), formation of joint venture has not proceeded to date
25 Powerco/Egmont Electricity (21 July 1997), merged

[1] Holdco has not been incorporated.

[2] As is its immediate parent, UtiliCorp South Pacific Inc.

[3] A wholly owned subsidiary of The Todd Corporation Ltd. Todd Electricity Ltd's only interests in power companies are held through its shareholding in Utilicorp.

[4] UtiliCorp controls a total shareholding in WEL of 39.6% as a result of its own shareholding and those of Wilmel Nominees Ltd, Todd Electrical Securities Ltd and Pohutukawa Nominees Ltd.

[5] A vehicle by which investment houses such as NZ Guardian Trust Ltd and National Mutual Ltd hold investments in utility companies.

[6] PNZ and EnergyDirect Corporation Ltd were regarded by the Commission as closely connected as a result of the approximately 20% shareholding of PNZ in EnergyDirect Corporation Ltd and the fact that the Commission had granted clearance for a friendly merger between PNZ and EnergyDirect Corporation Ltd. That proposed merger was rejected by shareholders of EnergyDirect Corporation Ltd.

[7] The current joint venturers are TransAlta New Zealand Ltd and Fletcher Challenge Ltd. After the power station is commissioned Mercury will enter the joint venture as an equal partner.

[8] Alternating current transmission voltages are mainly 220,000 volts, 110,000 volts and 66,000 volts. However, the direct current link between the North and South Islands runs at higher voltages.

[9] There are seven large industrial concerns whose plants are directly connected to Trans Power's transmission line network (rather than being supplied with electricity through the electricity network of a power company as are consumers other than the seven).

[10] The question of the application of section 48 of the Act was also discussed by the Court of Appeal in *PNZ v Mercury.* The Court considered that where an acquisition resulted merely in a bare transfer of dominance, the Commission could give a clearance in terms of section 66(3) to such an acquisition, because bare transfer was not an effect prohibited by section 47 of the Act.

[11] Mercury and UtiliCorp will, in terms of the Mercury/Utilicorp joint venture agreement, take steps to terminate the deed.

[12] Subsequently assigned to the WEL Trust, the transferee of the Waikato Electricity Authority's shares in WEL.

[13] As measured by a standard kilowatt-hour meter.

[14] At page 62 of its decision.

[15] Some of which were also made in the PNZ/Mercury staff report.

[16] The Ascot Park Hotel in Invercargill, Taylor Preston Ltd in Wellington and Shell/Todd Oil Services Ltd at Kapuni.

[17] For example, where TrustPower Ltd constructed a short extension of its network into the former franchise area of Tauranga Electricity.

[18] Estimated at 0.8% of an average business's total costs, if a 20% reduction in line charges is achieved.

[19] Thus making the two companies, in the Commission's view, interconnected bodies corporate.

[20] For example Alliance Ltd's Lorneville freezing works in Southland and the Ford Motor Company works in South Auckland.

[21] The Trans Power employee responsible for reconciling to generators the amount of electricity sold by competing retailers.

[22] A similar figure was evident in November 1997.

[23] Relevant figures are 137.5 gigawatt-hours in October 1995, 130.2 gigawatt-hours in March 1996 and 129.4 gigawatt-hours in January 1997.

[24] Pre merger, the largest four companies were: Mercury; PNZ; Capital Power/Energy Direct; and Southpower. Post merger, the relevant companies were: Mercury and Waitemata; Capital Power/Energy Direct; Southpower; and Valley Power.

[25] KPMG statistics published in The New Zealand Electricity Directory.

[26] Published by ANZ Securities (NZ) Ltd.

[27] Commissioner Harrison holds approximately 1,200 shares in WEL This matter is not considered, either by her or the Commission, to be an interest in terms of s 14 of the Act which disqualifies or would disqualify her from taking part in the consideration and determination of the notice seeking clearance.