MERCURY RESPONSE TO THIRD-PARTY SOPI SUBMISSIONS

1 Mercury responds to Vocus, Electric Kiwi and Mr David Riley's submissions on the Commission's 17 August 2021 Statement of Preliminary Issues (*SOPI*).

2 Those third-party documents contain, by and large, comment on the Tauranga Energy Consumer Trust (*TECT*), which is unrelated to Mercury and its clearance application to acquire Trustpower's retail assets.

3 Where the third-parties make submissions directed at Mercury's proposed acquisition, they tend to be consistent with the clearance application. To that end, Electric Kiwi and Vocus believe the acquisition "would help promote competition in electricity retailing".

4 Mercury expands below.

Broader context

5 Mercury has agreed to acquire Trustpower's retail assets set out in the parties' 19 June 2021 Sale and Purchase Agreement (the *Acquisition*). The Commission has the SPA.

6 The Acquisition's principal asset is Trustpower's mass market retail customer contracts.

7 The Acquisition excludes Trustpower's generation assets with Trustpower continuing to compete with Mercury and others in the wholesale electricity market with and without the Acquisition.

8 And the Acquisition also excludes any "Mercury-TECT dividend arrangement" because no such arrangements exist.[1] Mercury has no agreement or arrangement with TECT. Mercury will not acquire control or ownership of TECT, the TECT trust deed, or any influence over the TECT trustee's decision making.

9 Rather:

9.1 TECT holds trust assets for its beneficiaries;

9.2 TECT's beneficiaries – eligible for TECT distribution payments – have been, for years, people in the Tauranga area who are Trustpower customers;

[1] Contrary to Electric Kiwi and Vocus's submissions.

9.3 TECT's trustees decided to update that trust structure when Trustpower announced it was considering divesting its retail assets (with those assets including its Tauranga customer contracts);[2]

9.4 TECT's trustees have since decided to restructure the trust so that moving forward a beneficiary means:[3]

(a) *"each person who is named in the records of Trustpower as being liable to pay Trustpower any amount for electrical energy supplied or to be supplied to one or more ICPs situated in the District as at 9am on [28 January 2021]"*; and

(b) *"that person retains an obligation to pay Trustpower or a third party purchaser of all or a substantial part of Trustpower's business of supplying electrical energy to one or more ICPs in the District (a Third Party[4]), as the case may be, any amount for electrical energy supplied by Trustpower or that Third Party to the Consumer's ICP or ICPs, as the case may be in accordance with the Eligibility Criteria set out in Part 1 of the Rebate Policy";*

9.5 And, TECT's trustees filed an application in the Tauranga High Court on 14 May 2021 seeking approval under the Trusts Act 2019 to make those changes to the trust structure.

10 The SPA is conditional on:

10.1 Mercury obtaining Commerce Act clearance for the Acquisition;

10.2 the proposed TECT restructure being completed;

10.3 Trustpower shareholder approval; and

10.4 other standard commercial matters.

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[2] The Future of TECT, 18 February 2021 Consumer Information Memorandum (https://www.tect.org.nz/site_files/20903/upload_files/TECTCIM.pdf?dl=1).

[3] TECT Consumer Trust: *Draft Consumer Trust Deed being the existing TECT Trust Deed (as at 19 October 2016) and including proposed edits.* Found here: https://www.tect.org.nz/tect-proposal-2021/.

[4] Where "Third Party" includes *"a company or other entity to which the Third Party has sold all or a substantial part of the business so acquired from Trustpower that relates to the supply of electricity in the District"*.

11 The TECT restructure is not, on the other hand, dependent on Trustpower selling its retail assets or those assets being acquired by Mercury or anyone else. Mercury is not, and will never be, a party to the TECT trust deed.

Mercury's clearance application and the Commission's SOPI

12 Section 66 of the Commerce Act 1986 says that "a person who proposes to acquire assets of a business or shares may give the Commission a notice seeking clearance for the acquisition".

13 Mercury has applied to the Commission for clearance to acquire the SPA assets, principally Trustpower's book of retail customer contracts. Mercury's clearance application states in detail why it believes Mercury's acquisition of those contracts will not substantially lessen competition in any market.

14 The Commission's SOPI records the Commerce Act framework for analysing Mercury's clearance application. The SOPI observes that (emphasis added):

14.1 "[the Commission] determines whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds … with the likely state of competition if the acquisition does not proceed";[5] and

14.2 "[the Commission's] assessment of the Proposed Acquisition is limited to the impact of the transaction on competition in New Zealand markets. Except to the extent it is relevant to the Proposed Acquisition, *our clearance process does not involve assessment of the competitive workability of the relevant markets in general*".[6]

15 The SOPI invited third-parties to comment on the Commission's questions about the Acquisition developed from that legal framework.

16 The Commission received three submissions from Vocus, Electric Kiwi and Mr David Riley.

17 Despite the SOPI containing the Commission's framework, the third-party submitters, by and large, do not comment on the Acquisition.[7] Rather, the submitters use this clearance process principally to share their views on TECT by incorrectly tying that trust to the Acquisition.

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5 SOPI, at [9].

6 SOPI, at [4].

7 Other than the titles of their respective documents, Vocus and Electric Kiwi make no reference to the SOPI at all.

18 Mercury answers the third-party submissions by:

18.1 isolating and responding to the third-party's comments that relate to the Acquisition; and

18.2 observing that TECT and the TECT trustees' proposed restructure is not part of the Acquisition.

Acquisition-related SOPI submissions

19 Mercury explains in the clearance application that its acquisition of Trustpower's retail assets, being principally Trustpower's existing mass market retail customer contracts, will not substantially lessen competition in any market because:

19.1 **Point 1:** Mercury will continue to face competition from Genesis, Meridian, Contact, Nova, Electric Kiwi, Pulse, Vocus and over 20 electricity retailers around the country.

19.2 **Point 2:** All electricity retailers operating in the market constrain Mercury's retail electricity pricing because:

(a) all electricity retailers resell the same electricity purchased from the same wholesale electricity spot market regulated by the Electricity Authority;

(b) all electricity retailers face the same, low entry and expansion barriers and each must:

(i) buy electricity from the wholesale electricity spot market;

(ii) hedge the financial risks involved in buying and reselling electricity at the spot price as necessary and in a manner appropriate for their business model;[8]

(iii) enter into distribution arrangements with lines and metering companies; and

(iv) establish marketing, finance and other teams, processes and systems to run their business.

19.3 **Point 3:** the Acquisition will not affect other retailers' ability to operate in the New Zealand retail electricity market because:

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[8] We note, for instance, that some retailers, like Mercury, invest in additional generation capacity which is a natural hedge against price fluctuations in the wholesale electricity spot market.

(a) Mercury is only acquiring Trustpower's mass market retail assets (predominantly retail contracts); and

(b) Trustpower will continue to operate as a generator in the wholesale electricity market, just as it does today.

20 Electric Kiwi and Vocus appear to mostly agree with those points.[9] They say, for instance, that:

20.1 *"Electric Kiwi has been the fastest growing electricity retailer since we took on our first customers in December 2014. Our customer base has grown to 77,000 or 3.5% of the market, which makes us the largest retailer not controlled by, or integrated with, a generator. Our customers have benefited from market leading offers and service, and collectively saved $34 million since the beginning of 2015. We have been an aggressive price leader for the vast majority of this time which has pressured large retailers to lower their prices and resulted in significant savings for consumers in general".* (Consistent with Points 1 and 2, Electric Kiwi submission at p2).

20.2 *"… [Electric Kiwi's] residential customer base [is] benefiting from our market leading offers and service".* (Consistent with Points 1 and 2, Electric Kiwi submission at p4).

20.3 *"[Electric Kiwi] believe we are among the most efficient retailers in the market and have adopted a prudent hedge policy".* (Consistent with Point 2, Electric Kiwi submission at p4).

20.4 *"The large number of retailers but the low level of new entrant penetration indicates there are low barriers to entry but high barriers to growth".* (Consistent with Point 2, Electric Kiwi submission at p3. Mercury notes that the graph below showing the growth of independent electricity retailers does not support Electric Kiwi's claim that there are "high barriers to growth". Nor are those claims consistent with Electric Kiwi's own position as the fastest growing electricity retailer since December 2014. Indeed, it is hard to reconcile how there can be low entry barriers but high growth barriers).

20.5 *"Trustpower has lost the status of largest retailer in 7 of the 12 regional markets in which it is the incumbent. Trustpower is on the cusp of losing its*

[9] Mr Riley says he "[does not] have an opinion on the NZ wide issues relating to Trustpower and Mercury post acquisition apart from noting that any reduction in competition for a commodity such as electricity should be examined carefully" and, instead, focuses only on TECT.

status as largest retailer in 3 of the other areas". (Consistent with Points 1 and Point 2, Electric Kiwi submission at p7).

20.6 *"… reduction in retail-generation vertical-integration should result in more competition in the longer-term"*. (Consistent with Point 3, Electric Kiwi submission at p2).

20.7 *"… Vocus welcomes vertical-separation of any of the large incumbent gentailers' wholesale (generation) and electricity retail businesses"* (Consistent with Point 3, Vocus submission at p2).

20.8 *"Vocus considers that vertical-separation of the large incumbent gentailers' wholesale (generation) and electricity retail businesses would help promote competition in electricity retailing and enable independents retailers to compete on a more level playing field".* (Consistent with Point 3, Vocus submission at p8).

21 Despite making those submissions, Electric Kiwi and Vocus refer to challenges that some independent retailers have faced in recent times due to a period of elevated wholesale spot electricity prices. Different parties have different views on those prices and the Electricity Authority is, as always, actively monitoring the wholesale market.

22 The relevant point for this Acquisition is that electricity markets are volatile and at times wholesale spot prices will favour net generators and at other times they will favour net retailers. The effect of those spot price fluctuations on any particular electricity retailer, at any point in time, depends on that retailer's investment in hedge contracts, generation and/or other diversified businesses. The challenge of having capital to invest in those ventures is one that all businesses face across the economy, no matter the industry.

23 Mercury's acquisition of Trustpower's retail contracts does not change those operational business and investment challenges in any way. That is because:

23.1 Trustpower will continue to compete independently in New Zealand's wholesale electricity market; and

23.2 Mercury's acquisition of more retail mass market contracts would not affect independent retailers' access to wholesale electricity or their ability to otherwise compete in the retail market in any way.

24 Consistent with that position, Electric Kiwi and Vocus believe that the Acquisition would help promote competition in the retail electricity market by vertically

separating Trustpower. Mercury notes too that it anticipates the Acquisition will increase competition on the West Coast.[10]

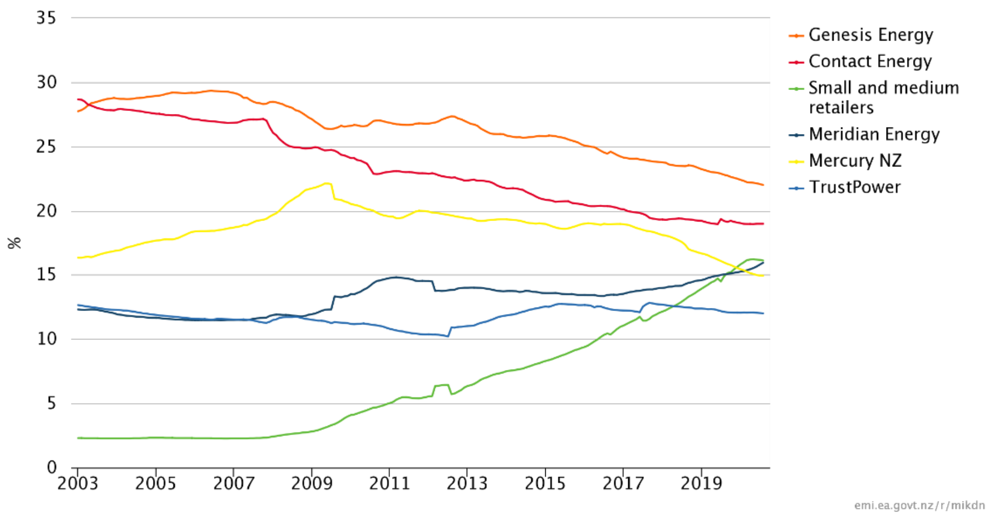
25 Further, there is nothing to suggest that it would be appropriate to remove or discount independent retailers from the Commission's competition analysis because of the challenges some might face today.

26 We say that because:

26.1 Wholesale electricity spot prices are in a constant state of flux: sometimes prices favour net generators and sometimes prices favour net retailers.

26.2 The wholesale electricity market is constantly monitored by the Electricity Authority which is active in implementing market changes.

26.3 The evidence is that independent electricity retailers have been able to compete effectively in the market over the last ten years despite occasional lulls in growth (see, for instance, 2011 and 2014):



26.4 And, the Electricity Authority's significant hedge market developments will make buying hedge products even more efficient moving forward (these developments are explained in detail in the clearance application).

27 It follows that there is no reason to treat independent retailers differently when assessing the competitive effects of this Acquisition on the retail electricity market.[11]

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[10] See 30 July 2021 Sapere Report at [10] and [119]-[125].

[11] Vocus and Electric Kiwi's submissions misconstrue the clearance application which responds to the same Commission question. Mercury repeats that the EPR did not find that independent retailers face barriers to expansion *because of the fact that* incumbent retailers, like Mercury and Trustpower, have large retail bases or because they have vertically-integrated wholesale electricity businesses. It follows that the fact that, post-Acquisition, Mercury would increase the size of its retail base does not increase expansion barriers of the type expressed in the EPR report and clearly summarised at [85]-[96] of the clearance application.

As Electric Kiwi submitted: "we *have been an aggressive price leader for the vast majority of this time which has pressured large retailers to lower their prices"*.

TECT

28 The third-party submitters use the SOPI process to state their views on the TECT distribution payment.

29 Those views are, however, unrelated to, and independent of, Mercury and the Acquisition.

30 There is no "Mercury-TECT dividend arrangement" as Electric Kiwi and Vocus assert.

31 The TECT distribution payment – which distributes TECT income – is determined by TECT trustees in accordance with the TECT trust deed. The TECT trustees' decision to restructure the trust so its beneficiaries will become Trustpower customers as at 28 January 2021 is not conditional on this Acquisition proceeding, nor does it involve Mercury.

32 We see that reflected in, for example, the TECT beneficiary definition set out above and the following excerpt from TECT's 18 February 2021 public consumer information memorandum:[12]

> As a result of all this, the Trustees of TECT are of the strong view that doing nothing is not an option. Trustees have agreed on a proposal for change. The Trustees' proposal is a response to Trustpower's strategic review, but the Trustees are clear that they wish to proceed with the restructure whether or not Trustpower's review leads to an immediate sale by Trustpower of its Retail Business.

33 Against that reality:

33.1 TECT, including in any restructured form, is not "part of" the Acquisition – TECT is not a good, service or other interest in land that Mercury will "acquire" under the Commerce Act 1986 should the Commission grant clearance; and

33.2 in any event, the TECT distribution payment will (or will not) exist in the market regardless of whether the Acquisition proceeds, so any effect of the TECT distribution payment will (or will not) occur in the market with or without the Acquisition.

34 In those circumstances, no matter what Vocus, Electric Kiwi and Mr Riley submit, Mercury's application for Commerce Act clearance to acquire Trustpower's retail

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12 The Future of TECT, 18 February 2021 Consumer Information Memorandum (https://www.tect.org.nz/site_files/20903/upload_files/TECTCIM.pdf?dl=1).

assets does not include TECT, the TECT restructure or any "Mercury-TECT dividend arrangement" which Vocus and Electric Kiwi wrongly say exist.