

Statement of Issues

Contact Energy Limited / Manawa Energy Limited

5 February 2025

Introduction

1. On 30 September 2024, the Commerce Commission registered a clearance application (the Application) from Contact Energy Limited (Contact) seeking clearance to acquire up to 100% of the shares in Manawa Energy Limited (Manawa) (the Proposed Acquisition).¹
2. As required by the Commerce Act 1986² (the Act), we assess mergers and acquisitions using the substantial lessening of competition test, which we describe further below.
3. To grant clearance for the Proposed Acquisition, we must be satisfied that it will not have, or would not be likely to have, the effect of substantially lessening competition in any market in New Zealand.
4. This Statement of Issues (Sol) sets out the potential competition issues we have identified following our initial investigation. This is so the parties and other interested parties can provide us with submissions relating to those issues.
5. In reaching the preliminary views set out in this Sol, we have considered information provided by the parties and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition concerns may arise, as the investigation continues.

The issues we are continuing to investigate

6. On the basis of the evidence collected to date, we are not currently satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a New Zealand market.
7. At this stage, we consider the most appropriate markets within which to assess the effect of the Proposed Acquisition on competition are:
 - 7.1 a national market for the wholesale supply of physical electricity;
 - 7.2 a national market for the supply of shaped hedges;³ and

¹ A public version of the Application is available on our website at: <https://comcom.govt.nz/case-register>.

² Commerce Act 1986, s66(3).

³ For an explanation of what shaped hedges are, see the Background section below.

- 7.3 a national market for the retail supply of physical electricity, and potentially more granular regional markets.
8. Manawa currently supplies some shaped hedges and, at this stage of our investigation, we consider that Manawa would likely supply some volume of shaped hedges to third parties absent the Proposed Acquisition.
 - 8.1 Manawa appears well positioned to supply shaped hedges, as it is one of the few generators with the flexible assets to underpin that type of contract.
 - 8.2 Absent the Proposed Acquisition, Manawa is likely to have some electricity volumes not committed to any hedges that it could sell as shaped hedges.
 - 8.3 We have some evidence that indicates, absent the Proposed Acquisition, Manawa may have an incentive to sell some portion of its generation in the form of shaped hedges to third parties such as independent electricity retailers. To this extent, the Proposed Acquisition would remove Manawa as an independent supplier of shaped hedges.
 - 8.3.1 There appears to be increasing demand for shaped hedges and customers are typically willing to pay a premium for shaped hedges.
 - 8.3.2 Currently Manawa supplies shaped hedges, which indicates it may have the ability and incentive to continue sell such hedges contracts, absent the Proposed Acquisition
9. At this stage, we have identified four main ways in which the Proposed Acquisition might harm competition in the markets we have identified above. We are seeking submissions and further information on all of these areas.
10. Firstly, there appears to be the potential for vertical effects in the supply of shaped hedges. We consider the merged entity may have the ability and incentive to foreclose its competitors – independent retailers and generators – by refusing to supply them with the shaped hedges that they can use to appropriately manage their financial risk and therefore function as effective competitors in the market.
 - 10.1 We currently consider that the merged entity may have market power in relation to the supply of shaped hedges due to its high degree of asset flexibility, the importance of shaped hedges to retailers and generators, and the lack of regulations around the supply that product, meaning that it may have the ability to foreclose rivals.
 - 10.2 At this stage, we also consider that the merged entity might have an incentive to foreclose its competitors. This is because, according to our initial estimates, the merged entity's gains from potential foreclosure (derived from higher retail sales and higher spot prices) might exceed any costs of potential foreclosure (the opportunity cost of not supplying shaped hedges).

- 10.3 Further, we are currently not satisfied that potential foreclosure strategies by the merged entity would not have an adverse effect on competition. As a result of the foreclosure, the competitiveness of independent retailers and generators is likely to be materially reduced.
11. Secondly, there appears to be the potential for unilateral effects in the supply of shaped hedges. At this stage, we consider that Manawa would likely supply some volume of shaped hedges to third parties absent the Proposed Acquisition. The Proposed Acquisition would therefore eliminate any future competition between Contact and Manawa in the supply of shaped hedges which is likely to be detrimental to customers seeking these types of hedges.
- 11.1 Gentailers that are able to supply shaped hedges have an incentive to prioritise the needs of their retail arms over the needs of other retailers. Manawa, as an independent generator, has no such incentive. Therefore, removing Manawa from the market might result in a lower overall supply of shaped hedges.
- 11.2 Further, there is currently a limited number of generators with the ability to supply shaped hedges and this number is unlikely to increase in the foreseeable future. As such, the Proposed Acquisition would likely remove one of the few options available for customers of shaped hedges.
- 11.3 In addition, for the foreseeable future, current customers of shaped hedges are unlikely to have any meaningful alternatives to shaped hedges to enable them to constrain a price increase in shaped hedges by the merged entity.
12. Thirdly, it appears the Proposed Acquisition has the potential to raise unilateral effects in the wholesale supply of physical electricity. We consider that the aggregation of the Parties' businesses would result in a merged entity with a substantially greater ability to impact the average wholesale electricity spot price more than Contact or Manawa would be able to do independently of one another.
- 12.1 In testing this potential, the Commission has been assessing concepts of 'gross' and 'net' pivotality, which are measurements that electricity market participants can use to assess the ability of an electricity generator to unilaterally affect the level of the spot price. Economic analysis submitted by Contact indicates that the frequency of the merged entity's gross pivotality would be limited and that it would never be net pivotal. We asked the EA to review these findings. After a preliminary assessment, the EA identified some discrepancies in relation to merged entity's net pivotality compared to Contact's analysis. We continue to investigate the source of the differences.
- 12.2 We are also considering whether the merged entity could unilaterally affect the level of the spot price, regardless of its level of pivotality. We are assessing whether, as a result of the Proposed Acquisition, the merged entity might be able to shift its output away from trading periods when sensitivity of spot prices to electricity supply is high to periods when it is low. Such a

strategy could, in principle, lead to higher average spot prices and could benefit the merged entity financially. At this stage, we are not satisfied that the merged entity would not have the ability and the incentive to engage in that strategy.

13. Fourthly, we are currently not satisfied that the Proposed Acquisition would not give rise to coordinated effects in the market for the wholesale supply of physical electricity. At this stage, this market appears to be concentrated (in other words, containing relatively few competitors) and has features that make it vulnerable to coordination, and the removal of Manawa may make coordination more likely, complete or sustainable. This is because – after the Proposed Acquisition:
 - 13.1 the merged entity would have a wider geographic spread of assets giving it greater ability to influence electricity volumes and prices at different nodes;
 - 13.2 the merged entity would have a greater level of asset flexibility, making adhering to potential terms of coordination easier; and
 - 13.3 there would be a greater degree of symmetry between generators in terms of vertical integration which may make potential coordination more sustainable.

The issues that do not currently raise concerns

14. We are currently of the view that the Proposed Acquisition would not be likely to cause a substantial lessening of competition due to:
 - 14.1 Unilateral effects for new investment in electricity generation. We have considered whether – as a result of removing Manawa from the pool of potential investors in new generation – the Proposed Acquisition would be likely to reduce the overall level of investment in new electricity generation in New Zealand. The evidence suggests that Manawa is not an important player in new generation development and, as such, removing it is unlikely to affect rivals' incentives to invest.⁴ Further, even if the merged entity was to abandon some of the projects currently in Contact and Manawa's respective pipelines (for example, planned projects that may share similar geographic locations), we do not consider that would materially reduce the level of new generation or result in higher levels of spot prices in the medium to long term. This is because there appears to be a sufficiently large pipeline of projects to build new assets by other suppliers, including new entrants.
 - 14.2 Coordinated effects in the supply of shaped hedges. Overall, the market for the supply of shaped hedges does not appear vulnerable to coordination as prices and volumes of shaped hedges are not transparent and there does not appear to be a straightforward coordination mechanism given the complexity

⁴ The removal of Manawa, in itself, is unlikely to affect rivals' incentives to invest because Manawa does not appear to be an important force in building new assets. However, the Proposed Acquisition may affect rivals' (including new entrants') incentives to build new assets to the extent that merged entity might restrict rival generators' access to inputs required to invest in new assets, eg, hedges. We discuss this in the ability section of our vertical effects discussion.

of shaped hedge products. Further, we consider the Proposed Acquisition is unlikely to materially increase the ability of suppliers of shaped hedges to reach a coordination agreement or increase the sustainability of such an agreement.

- 14.3 Unilateral effects for the supply of ancillary services. The overlap between the merging parties in the supply of instantaneous reserves (a form of ancillary services) appears minor. As such, any aggregation is unlikely to affect competition for the supply of these services.
15. We do not discuss the above further in this Sol but welcome submissions on any of these points.

Our framework

16. As noted in our Statement of Preliminary Issues and earlier in this Sol, the Act requires us to assess mergers and acquisitions using the substantial lessening of competition test. The Act, together with relevant case law, governs the way in which we consider all mergers, including the Proposed Acquisition. Our approach to this assessment is also based on the principles set out in our Mergers and Acquisitions Guidelines (Guidelines).⁵
17. We determine whether a merger or acquisition is likely to substantially lessen competition in a market by considering what would change with a merger. We do so by comparing the likely state of competition if a merger proceeds (the scenario with a merger, often referred to as the factual), with the likely state of competition if a merger does not proceed (the scenario without a merger, often referred to as the counterfactual).⁶ This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
18. Whether or not a lessening of competition as a result of a merger is substantial depends on the particular circumstances.⁷ It is the degree to which competition has been lessened which is critical. A lessening of competition does not need to be felt across an entire market, or relate to all dimensions of competition in a market, for that lessening to be substantial. A lessening of competition that adversely affects a significant section of the market may be enough to amount to a substantial lessening of competition.⁸ Further, in markets that are already concentrated, a smaller change in competition with a merger may amount to a substantial lessening of competition than would be the case in markets that are less concentrated to begin with.⁹
19. In considering the Application and assessing whether the Proposed Acquisition is likely to substantially lessen competition, our focus is on what would change with

⁵ Commerce Commission, Mergers and Acquisitions Guidelines (May 2022). Available on our website at www.comcom.govt.nz.

⁶ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁷ *ANZCO Foods Waitara Ltd v AFFCO NZ Ltd* (2005) 11 TCLR 278 at [240] (CA).

⁸ *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 64 FLR 238; ATPR 40-315, 43,888.

⁹ M Sumpter, *New Zealand Competition Law and Policy* (CCH, Auckland, 2010) at 186-187, discussing the decision in *Air New Zealand v Commerce Commission* (2004) 11 TCLR 347 (HC).

the Proposed Acquisition. Unless we are satisfied that any lessening of competition as a result of the Proposed Acquisition is not likely to be substantial, we cannot give clearance.

Process and timeline

20. We have agreed with Contact an extension of the period in which to make a decision until **31 March 2025**. Further extensions may be agreed between the Commission and the Applicant.
21. We would like to receive submissions and supporting evidence from Contact, Manawa and other interested parties on the issues raised in this Sol. We request responses by close of business on **21 February 2025**, including a confidential and a public version of any submission made. All submissions received will be published on our website with appropriate redactions.¹⁰ All parties will have the opportunity to cross-submit on the public versions of submissions received from other parties. Cross-submissions should be received by close of business on **28 February 2025**.
22. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The Parties and the Proposed Acquisition

23. Contact and Manawa (each a Party and together, the Parties) are involved in the generation and wholesale supply of electricity in New Zealand.
 - 23.1 Contact generates electricity from two hydro dams in the South Island as well as from geothermal and thermal power stations located across the North Island.¹¹
 - 23.2 Manawa generates electricity from 25 hydro schemes located across New Zealand and one thermal power station in Northland.¹² Manawa was formerly known as Trustpower, having been rebranded following the sale of Trustpower's retail business to Mercury NZ Limited (Mercury) in 2022.¹³
24. Contact and Manawa both wholesale the electricity they generate to electricity retailers as well as to large commercial and industrial end users. Contact is one of several 'gentailers' in New Zealand because it both generates and retails electricity to all types of customers. However, unlike Contact, Manawa does not directly sell

¹⁰ Confidential information must be clearly marked (by highlighting the information and enclosing it in square brackets). Submitters must also provide a public version of their submission with confidential material redacted. At the same time, a schedule must be provided which sets out each of the pieces of information over which confidentiality is claimed and the reasons why the information is confidential (preferably with reference to the Official Information Act 1982).

¹¹ The Application at [2.8].

¹² The Application at [3.7].

¹³ *Mercury NZ Limited and Trustpower Limited's retail business*, [2021] NZCC 16.

electricity to any retail/residential customers. As a result, Manawa is a generator, not a gentailer.

25. Under the Proposed Acquisition, Contact will acquire 100% of the shares in Manawa.

Relevant background

26. The Application relates to the supply of electricity in New Zealand and this section summarises some of the key industry information including:

- 26.1 how electricity is supplied in New Zealand;
- 26.2 some of the main industry participants;
- 26.3 the different types of hedge contracts; and
- 26.4 how we expect the electricity industry will change in the future.

How electricity is supplied in New Zealand

27. Both Contact and Manawa are electricity generators and all generators of electricity must comply with the industry obligations set out in the Electricity Industry Participation Code 2010 (the Code), which is administered by the Electricity Authority (EA).¹⁴
28. The EA sets out the following information on how the wholesale supply of electricity occurs in New Zealand, some of which Contact referenced in its Application.¹⁵
- 28.1 At the wholesale level, generators sell electricity to retailers and commercial and industrial (C&I) customers. Retailers then on-sell that electricity to businesses and households across New Zealand.
 - 28.2 When buying electricity at the wholesale level, retailers (or any other wholesale customer) will pay the 'spot price' for the electricity they required.
 - 28.2.1 The spot price of electricity differs depending on the combination of supply, demand and distance from the source of the electricity generated.¹⁶ Generators submit 'offers' to supply electricity in half hour increments at a particular price, and retailers and other customers submit 'bids' for electricity to be supplied. The price is calculated in half hour increments based on these bids, offers and a forecast of expected demand, for trading a week in advance.¹⁷
 - 28.2.2 The 'spot' price for each half hour is set by the price offered by the last power station whose power is required to fulfil the demand.¹⁸ All

¹⁴ The Application at [8.7] and <https://www.ea.govt.nz/code-and-compliance/code/>.

¹⁵ The Application at [8.1]-[8.5] and <https://www.ea.govt.nz/industry/wholesale/>.

¹⁶ <https://www.ea.govt.nz/industry/wholesale/>.

¹⁷ <https://www.ea.govt.nz/industry/wholesale/spot-market/>.

¹⁸ The Application at [8.3].

generators whose power is required to fulfil wholesale demand in the particular half hour slot are then paid that spot price for the electricity they produce, even if the price they offered to supply electricity for is cheaper than that spot price.¹⁹

28.2.3 The spot price can be volatile depending on market conditions. The EA notes that the volatility in the spot price is because prices are determined by supply and demand and can therefore vary depending on factors like the amount of wholesale electricity available (which in turn can vary based on how dry the lakes are at a generator's hydropower station, or the amount of wind at a generator's windfarm).²⁰ While consumers are typically insulated from these spikes in prices (at least in the short run), businesses, particularly those that require a lot of electricity, can see huge increases in the costs of running their operations.²¹

28.2.4 To manage this volatility, wholesale market participants have the option of entering into financial contracts, or hedges. Hedges involve the purchase of insurance against spot price volatility rather than the purchase of physical electricity. Purchasers of hedges receive insurance against high spot prices (and sellers receive insurance against low spot prices). By selling hedges, wholesalers gain certainty over the stream of revenue from the generated electricity. As discussed in the section on the different types of hedge contracts, there are several types of hedges offering customers different levels of protection against spot price volatility.

Main industry participants

29. The Proposed Acquisition relates to two key types of electricity market participants, namely entities that generate electricity and entities that retail the electricity that is generated.
30. While lots of companies generate electricity, currently five entities generate the majority of electricity produced in New Zealand: Contact, Manawa, Meridian Energy Limited (Meridian), Mercury NZ Limited (Mercury) and Genesis Energy Limited (Genesis).²²
31. Meridian, Mercury and Genesis are similar to Contact in that they each generate and retail electricity (as such, they are also 'gentailers'). While there are some other

¹⁹ The Application at [8.3].

²⁰ For example, between July and early August 2024 wholesale electricity prices increased from approximately \$300/MWh to over \$800/MWh due to a combination of low hydro generation output and more expensive forms of generation then being required to fill the gap between demand and supply (<https://www.ea.govt.nz/news/eye-on-electricity/what-was-behind-high-wholesale-electricity-prices/>).

²¹ <https://www.ea.govt.nz/news/eye-on-electricity/what-was-behind-high-wholesale-electricity-prices/>.

²² <https://www.ea.govt.nz/your-power/new-zealands-electricity-sector/>.

entities that also generate and retail electricity,²³ Contact, Meridian, Mercury and Genesis are commonly referred to as the 'Big Four' gentailers.

32. In addition to Manawa, there are other electricity generators that do not have a retail arm and so these tend to be referred to as independent generators. Such independent generators include Lodestone Energy Limited and NZ Windfarms Limited.
33. Independent retailers of electricity (ie, those who are not vertically integrated with a generator) include Electric Kiwi Limited, Two Degrees Mobile Limited, Octopus Energy NZ Limited and Flick Electric Limited, who retail electricity mainly to residential and small to medium enterprise (SME) customers.
34. The electricity that is generated at power stations is sent across the country through large transmission lines. Transpower New Zealand Limited (Transpower) is the state-owned enterprise that provides the transmission infrastructure and systems that connects electricity generators to major energy users and distribution networks that delivery electricity to homes and businesses across NZ.²⁴ Transpower looks after the assets that ensure electricity is flowing and manages how electricity gets from generation to end-users. Any generator that wants to wholesale electricity to customers needs Transpower's approval to be able to connect their power station to the transmission network.

The different types of hedge contracts

35. Contact and Manawa, as well as other generators, supply a range of hedge products. We explain how the types of hedges differ in more detail below.
36. Firstly, hedges can be of variable or fixed volume:
 - 36.1 Variable hedges – where the price of electricity is fixed but volume of electricity covered is variable. Such contracts can be load (demand) or generation (supply) following. Generators who sell generation following contracts (also known as power purchase agreements, or PPAs) sell all or some proportion of the output from their individual plants.
 - 36.2 Fixed hedges – where both the price and volume of electricity covered are fixed. Such contracts can be either baseload or shaped.
 - 36.2.1 Baseload – covers all trading periods during the duration of the hedge. Baseload hedges are typically provided by generators with assets that are relatively inflexible in term of the amount of electricity that they produce (eg, geothermal). That is, the relevant power station cannot easily increase the amount of electricity that it is producing on demand.

²³ Such as Nova Energy Limited and Pulse Energy (through Buller Electricity Limited).

²⁴ <https://www.transpower.co.nz/about-us/what-we-do>.

- 36.2.2 Shaped – covers specific trading periods. Shaped hedges can be further differentiated by the time of day they provide cover for, with peak shaped products generally covering volumes for trading periods between 6am and 11pm and super-peak shaped products generally covering trading periods between 6am and 10.30am, and between 5pm and 11pm.²⁵ Shaped hedges are typically provided by generators with flexible types of generation (such as flexible hydro and thermal) as the amount of generation these assets produce can be increased or decreased by the generator. This allows generators with flexible assets to offer products that have a degree of ‘shape’ to them.
37. Secondly, hedges can vary depending on the channel through which they are supplied (or traded). There are three broad categories of channels.
- 37.1 Australian Stock Exchange (ASX) hedges (ASX Hedges). Trading hedges on the ASX is anonymous and standardised. Trading regulations in New Zealand require all gentailers to offer a certain amount of electricity in the form of baseload hedges on the ASX. In addition, peak and, from January 2025, super-peak contracts, can be traded on the ASX (ASX Super-peak Hedges).²⁶ Unlike the supply of baseload ASX Hedges, the supply of ASX peak and Super-peak Hedges is not currently mandatory for gentailers.
- 37.2 Over the counter (OTC) hedges (OTC Hedges). These are hedges traded via bilateral negotiations between buyers and sellers. Sellers do not have any requirements to supply OTC Hedges of any type to customers. Unlike ASX Hedges, the terms of OTC Hedges can be adjusted to the parties’ requirements. OTC Hedges can be baseload (Baseload OTC Hedges) or shaped to fit a particular demand profile (Shaped OTC Hedges).
- 37.3 Financial transmission rights (FTR) hedges. Electricity can be transmitted between different parts of the country, but the longer the distance of transmission, the larger the electricity losses incurred. As a result, there are differences in spot prices across different nodes. These differences can be amplified if there are bottlenecks in the electricity grid. To protect against the geographic differences in spot prices, generators trade in FTR hedges.
38. Much of our discussion in this Sol concerns peak and super-peak hedges, sold on both an ASX and OTC basis (which we refer to collectively as ‘Shaped Hedges’). The new ASX Super-peak Hedge product falls within this definition. As we set out at various points in this Sol, we invite submissions on what the existence of ASX Super-

²⁵ For completeness, we note that the periods covered by the new ASX Super-peak Hedges (which we discuss below) are 7-10.30am and 5-9pm.

²⁶ See <https://www.ea.govt.nz/news/general-news/new-standardised-flexibility-product-trading-begins-on-28-january/> and <https://www.ea.govt.nz/news/general-news/energy-competition-task-force-announces-new-standardised-super-peak-hedge-contract-trading-begins-in-january/>.

peak Hedges means for our assessment of the Proposed Acquisition and how this product might impact the wider industry.

39. Hedges are generally traded by four types of customers:
- 39.1 Independent retailers, who buy hedges to protect themselves from fluctuations in the spot price of electricity. Because their end-consumers' demand for electricity varies within a day and across seasons, retailers typically seek different types of hedges (including baseload, peak and super-peak contracts) to manage these variations. Independent retailers purchase hedges on both an ASX and OTC basis.
 - 39.2 C&I customers, who also buy hedges to protect themselves from fluctuations in the spot price of electricity. Because their energy consumption is generally predictable and stable – often limited to the working hours on weekdays – C&I customers tend to predominantly buy baseload hedges, either on an ASX or OTC basis.
 - 39.3 Generators (including both independent generators and gentailers), who purchase ASX or OTC Hedges from their rivals to complement their own generation. For example, generators who produce renewable, intermittent energy may buy hedges to ensure that they are not exposed to high spot prices in periods when their electricity production is low.
 - 39.4 Financial institutions, who buy and sell hedges speculatively and without any backing in generation. They provide liquidity in hedge trading but do not physically supply electricity.
40. As part of the sale of Trustpower's retail business to Mercury, Manawa has a long-term electricity supply agreement with Mercury in the form of a Shaped Hedge (the Mercury Hedge).²⁷ The agreement was initially for 2,000GWh per annum, however since 1 October 2024 Manawa's volumes committed to the Mercury Hedge have begun to roll off. Manawa's commitments under the Mercury Hedge conclude on 30 September 2031.

Expected future changes to the electricity industry

- 41. Relevant to our assessment of the Proposed Acquisition, the electricity industry is experiencing significant changes, primarily driven by the transition to intermittent renewable energy sources such as solar and wind and the retirement of carbon producing assets such as thermal generation.²⁸ While the shift in generation types will contribute to a more sustainable energy mix, their variability will necessitate a change in how the grid is managed.
- 42. The transition to renewables is likely to increase volatility on the spot market as the intermittent nature of this type of generation leads to greater variability in supply.

²⁷ The Application at [13.2].

²⁸ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024), p. 3.

This is because intermittent sources of energy are reliant on suitable weather conditions (ie, solar generation requires the sun to be shining and wind generation requires it to be windy). This is likely to result in an increased frequency of trading periods with greater spot price variability (ie, either very high or very low spot prices as compared to the average spot price level).

43. At the same time as supply is becoming more uncertain, demand for electricity is forecast to increase. The results of the Ministry of Business, Innovation and Employment (MBIE) Electricity Demand and Generation Scenarios show that electricity demand is expected to rise in all forecast possible future demand scenarios.²⁹ This is due to increased demand from commercial and industrial sectors, the rise in electric vehicles, the switch from fossil fuel usage to electricity and a rise in residential demand for heating.
44. Consequently, supplying electricity to customers is likely to become riskier for retailers. As such, their demand for the risk management products described earlier is expected to grow. Demand for Shaped Hedges is particularly expected to rise, as these risk management products are able to be shaped to mirror the expected demand needed to supply the retailer's customers, thus limiting the retailer's exposure to periods of very high spot prices.
45. Existing generators, and new entrants supplying renewable, intermittent energy are also likely to demand a greater number of Shaped Hedges in the future. While renewable forms of generation are desirable as they are more climate friendly, the uncertainty of intermittent generation can pose a challenge for generators in terms of their ability to consistently supply electricity to customers. To the extent that such generators sell hedges to retailers or C&I customers, they may require Shaped Hedges to manage the risk of having to buy electricity on the spot market at potentially very high prices when their generation assets are not producing power and to provide certainty to their customers that they can consistently supply them with power. In a time when more generation assets are required to fulfil projected demand, access to risk management products such as Shaped Hedges may therefore affect how willing companies are to invest in new generation in New Zealand, and how competitive they can be once that generation comes online.
46. As we note earlier, from January 2025 onwards customers have the option of purchasing Super-peak Hedges on the ASX. This product has been introduced with the aim of improving competition in the wholesale electricity market as it is designed to help market participants manage their spot price risk when demand is likely to be at its highest and intermittent generation may be low.³⁰ Unlike with baseload ASX Hedges, this product is currently not mandatory for gentailers to offer.
47. At the same time as demand for Shaped Hedges is increasing, their supply is expected to decrease. This is because the stock of flexible assets which underpin

²⁹ Ministry of Business, Innovation and Employment – 'Electricity Demand and Generation Scenarios: Results summary' (July 2024) at p 1.

³⁰ <https://www.ea.govt.nz/news/general-news/energy-competition-task-force-announces-new-standardised-super-peak-hedge-contract-trading-begins-in-january/>.

Shaped Hedges – thermal and flexible hydro plants – is likely to shrink in the future as thermal plants (which are carbon producing) are retired. Flexible hydro plants will therefore increase in importance, as they will be the only meaningful form of generation capable of providing Shaped Hedges to independent retailers and independent generators (who may be existing generators or potential new entrants).³¹

48. Given that the above expected changes are likely to have a material impact on the industry going forward, we consider it appropriate to assess the Proposed Acquisition within the context of the future expected conditions in the supply of wholesale electricity, rather than against the status quo conditions.
49. Also relevant to our understanding of the future conditions in the supply of wholesale electricity is the creation of the Energy Competition Task Force.³²
- 49.1 In August 2024, the EA and the Commerce Commission jointly established the Energy Competition Task Force, which is currently investigating ways to improve the performance of the electricity industry for the long-term benefit of New Zealand consumers.
- 49.2 The Energy Competition Task Force’s work programme focuses on two overarching outcomes: enabling new generators and independent retailers to enter, and better compete in the industry; and providing more options for end-users of electricity. The Task Force’s outcomes will encourage more and faster investment in new electricity generation, boost competition, enable homes, businesses and industrials to better manage their own electricity use and costs and put downward pressure on prices.
50. Since the time of the Commission’s decision to issue the Sol,³³ the Energy Competition Task Force has introduced some initiatives. The Commission will be closely considering any relevant outcomes of the Task Force as part of its consideration of the Proposed Acquisition, including any regulatory changes. Importantly, as noted above, we determine whether a merger or acquisition is likely to substantially lessen competition in a market by considering what would change with a merger. We do so by comparing the factual scenario with the counterfactual scenario. Therefore, while the scope of any future regulatory changes stemming from the work of the Energy Competition Task Force is currently unknown, any changes will likely occur in both the factual scenario and the counterfactual scenario. To this extent, the Commission’s assessment is continuing to focus on what would change as a result of the Proposed Acquisition.

³¹ As we discuss further below, we consider that batteries and the use of demand response are both unlikely to be capable of providing meaningful volumes of Shaped Hedges.

³² <https://www.ea.govt.nz/projects/all/energy-competition-task-force/>

³³ <https://comcom.govt.nz/news-and-media/media-releases/2024/commission-to-issue-statement-of-issues-on-contacts-proposed-acquisition-of-manawa>

Market definition

51. Market definition is a tool that helps identify and assess the competitive constraints a merged firm is likely to face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.³⁴
52. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products which fall outside the market, but which still impose some degree of competitive constraint on the merged entity.³⁵
53. Our current view is that defining the following markets would best isolate the key competition issues that are likely to arise from the Proposed Acquisition:
 - 53.1 a separate national market for the wholesale supply of physical electricity;
 - 53.2 separate national markets for the supply of the main type of hedges and in particular, a market for the supply of Shaped Hedges; and
 - 53.3 a separate national market for the retail supply of physical electricity, and potentially more granular regional markets.
54. We invite submissions on our current approach to market definition and for parties to provide us with further evidence on the scope of the relevant markets.

The market for the wholesale supply of electricity

55. Contact submits there is a single national market for the wholesale supply of electricity, which it considers is consistent with past approaches by the Commission.³⁶ In support of this market definition, Contact submits that:
 - 55.1 there is no need to define narrower product markets based on:
 - 55.1.1 the contractual mechanisms (or hedges) through which market participants trade electricity, because all types of hedges are linked to the expectation of what future spot prices will be,³⁷ or
 - 55.1.2 how the electricity was generated (such as by wind or by hydro) because, although different types of generation have different

³⁴ Mergers and Acquisitions Guidelines above n5 at [3.7]-[3.8].

³⁵ Section 3(1A) of the Commerce Act 1986. See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81] and Mergers and Acquisitions Guidelines above n5 at [3.7]-[3.10].

³⁶ The Application at [16.1]-[16.2]. The previous approaches are set out in *Contact Energy Limited and Natural Gas Corporation Holdings Limited*, 2003 (Decision No. 491) and *Mercury NZ Limited and Trustpower Limited's retail business*, [2021] NZCC 16.

³⁷ The Application at [17.1]-[17.2].

characteristics, the physical supply and demand for electricity involves interaction between all types of generation;³⁸

- 55.2 there is no need to define narrower regional geographic markets because electricity is supplied on a national basis and, if there were to be any particular regional transmission “bottlenecks” or constraints impacting on national supply, Contact and Manawa do not significantly overlap in any particular region of New Zealand;³⁹
- 55.3 there is no need to define separate customer markets because all wholesale customers, whether they are retailers or commercial and industrial customers, have the same alternatives;⁴⁰ and
- 55.4 there is no need to define separate temporal markets (such as in summer or in winter) because, although demand and supply have different characteristics at different points in time, the mechanisms to balance demand and supply are the same throughout the year.⁴¹

Product dimension – wholesale supply of physical electricity vs supply of hedges

56. At this stage, we consider it is appropriate to assess a separate product market for the wholesale supply of physical electricity (sold at the spot market) and a separate market for the supply of hedges. This is primarily because purchasing physical electricity and purchasing hedges appear to be complements, rather than substitutes.
57. To date, we have received consistent feedback that purchasing physical electricity and purchasing hedges are not interchangeable, but instead complement each other.

Demand side considerations in assessing wholesale electricity products

58. When assessing the relevant product dimension, we assess what electricity products wholesale customers regard as close substitutes, and whether they would switch sufficient purchases to these products to make a Small Significant Non-transitory Increase in Price (SSNIP) unprofitable. In this section, we consider whether a hypothetical small increase in the spot price of wholesale electricity would be unprofitable due to customers switching away to hedges. If such a strategy is found to be unprofitable, physical electricity and hedges are likely to be in the same market (and vice versa).
59. Wholesale customers can buy physical electricity directly (paying the spot price) and, to insure themselves against future spot price fluctuations, they can also buy hedges. We consider that, from a demand perspective, the two products are not substitutes and serve different purposes.

³⁸ The Application at [17.5]-[17.6].

³⁹ The Application at [20.1]-[20.7].

⁴⁰ The Application at [17.4].

⁴¹ The Application at [18.1]-[18.2].

- 59.1 Purchasing electricity on the spot market involves the purchase of physical electricity (for example, retailers will typically purchase the amount of electricity needed to match the demand from their customers), whereas hedges do not involve the purchase of physical electricity, but instead involve the purchase of what is effectively an insurance product to protect against high spot prices. Only money changes hands under a hedge contract.
- 59.2 Functionally, hedges offer the ability for wholesale customers and suppliers to manage the risk of volatile high prices, while purchasing on the spot market (and paying the spot price) does the opposite, and exposes the customer and supplier to potentially volatile spot prices.
- 59.3 The complementary nature of wholesale physical electricity and hedges is apparent when considering a price shock in relation to the former. If, all else equal, the spot price of wholesale physical electricity were to increase, its volume demanded by customers – retailers and C&I customers – is likely to decline. Due to lower purchases of wholesale physical electricity, customers' exposure to spot price volatility would decrease. To manage the lower exposure, retailers' demand for hedges would shrink. Conversely, in response to a lower price of wholesale electricity, customers are likely to demand more of it and, consequently, will require higher levels of protection against spot price volatility.
- 59.4 We have received feedback that hedge contracts are not used as an alternative to purchasing physical electricity and they are an important product used by almost all market participants.⁴² There appears to be a clear demand for these products specifically, as distinct from demand for purchasing physical electricity directly.
60. Given the above, it appears unlikely that purchasing hedging contracts and purchasing electricity directly are substitutes for one another. Accordingly, from the demand side, our current view is that it would be appropriate to assess a product market for the wholesale supply of hedges separately from the wholesale supply of physical electricity.

Supply side considerations in assessing wholesale electricity products

61. On the supply side, we are assessing whether rival firms (having observed an increase in price of one product/service) can easily, profitably and quickly (generally within one year) switch production to supply the products or locations in question without significant costs so that a SSNIP is not profitable.
62. We consider that while if the spot price was to increase relative to the price of hedges suppliers could easily and quickly switch to increasing supply on the spot

⁴² For example, see Commerce Commission interview with [] (25 October 2024), Commerce Commission interview with [] (30 October 2024), Commerce Commission interview with [] (31 October 2024), Commerce Commission interviews with [] (1 November 2024), Commerce Commission interview with [] (1 November 2024) and Oji Fibre Solution - Submission in response to Statement of Preliminary Issues (7 November).

market by generating more electricity, the reverse is not true. If the price of hedges was to increase relative to the price of spot prices, it might not necessarily follow that suppliers would have the ability or incentive to increase their supply of hedges. This is because the evidence currently before us suggests that a generator's supply of hedges is often influenced by factors other than price.

- 62.1 The generator's particular risk appetite will determine how incentivised it is to offer any surplus generation as hedges. For example, more risk-averse generators prefer to be 'long' on electricity. An increase in the price of hedges relative to spot price might not be enough to incentivise generators to shift their strategic priorities and supply more hedges. Related to this is the needs of any retail arm, as gentailers are naturally incentivised to support their retail book by making sure it is appropriately hedged before offering hedges to the wider market (ie, to their competitors or customers). A gentailer might not supply more hedges – even if hedge price relative to spot price were to increase – if it meant that its own retail operations are not covered. Further, if it was sufficiently profitable, gentailers could choose to be exposed to the spot price for a portion of their retail book.
- 62.2 Gentailers must also weigh up the extent to which it is in their interest to provide their competitors with products that might allow them to compete more effectively against them. To the extent that selling hedges would give a gentailer's rivals a competitive advantage, the gentailer might be incentivised not to sell hedges, even if their price – relative to spot price – were to increase.
- 63. We also consider that, from a supply side perspective, the supply of physical electricity and hedges are complements rather than substitutes. This is because:
 - 63.1 if there is an increase in the spot price, generators are likely to supply more electricity (to the extent they are able to) to capture the gains associated with high electricity prices;
 - 63.2 however, supplying more electricity can mean a generator is more heavily exposed to spot price volatility, and it may become longer on electricity;
 - 63.3 as a result, a generator that sells more physical electricity is likely to also want to sell more hedges to insure against low spot prices caused by volatility.
- 64. Accordingly, on the supply side, we currently consider that it would be appropriate to assess a product market for the supply of hedges separately from the supply of physical electricity.

Product dimension – different types of hedges

- 65. While we consider it is appropriate to assess the hedges separately from the supply of physical electricity, we note that hedges are also differentiated by type, channel and customer. To this extent, given the demand and supply side considerations outlined below, we currently consider that it would be appropriate to also define

granular product markets for each of the different types of hedges. Relevant to our competitive assessment, we consider it appropriate to define a discrete product market for the supply of Shaped Hedges.

Demand side considerations in assessing different types of hedges

66. On the demand side, the evidence gathered to date suggests that it is appropriate to define granular product markets for each of the main types of hedges, such as baseload hedges, PPAs and Shaped Hedges.
67. Baseload hedges and Shaped Hedges are unlikely to be close substitutes because they appear to serve different purposes.
- 67.1 Baseload hedges and Shaped Hedges are risk management tools for different times of the day and as such are unlikely to be considered as viable substitutes by wholesale customers such that a price rise in Shaped Hedges would mean customers would switch to purchasing baseload hedges. Independent retailers told us that they particularly require Shaped Hedges in order to better manage risks associated with spot price volatility during the periods of high demand, which in turn allows them to be more competitive on price and therefore compete more successfully for customers.⁴³ This indicates that baseload hedges are unlikely to give a similar level of protection against spot price volatility as Shaped Hedges. The difference in the value of Shaped Hedges is reflected in their price, as this type of hedge is more expensive compared to baseload hedges.⁴⁴ We consider that the customers' willingness to pay more for Shaped Hedges than baseload hedges is consistent with the two products being in separate markets.
- 67.2 We accept that there may be times when baseload hedges could act as a potential substitute for Shaped Hedges if the volatility of the spot price was low, if the demand for physical electricity was fairly constant during the day, or if they are used in conjunction with another form of risk management tools such as batteries or demand response (which we discuss below).⁴⁵ In this instance customers might switch to purchasing baseload hedges in response to a price rise in Shaped Hedges. However, spot prices can vary materially depending on the availability of supply and the level of demand, while the demand for physical electricity is typically higher during peak hours than during off-peak hours. As set out earlier it is likely that spot price volatility will increase in the future. As such, there might be limited circumstances (now or

⁴³ Commerce Commission interview with [] (31 October 2024), Commerce Commission interview with [] (30 October 2024) and Commerce Commission interview with [] (31 October 2024). See also Electric Kiwi – 'Submission on Statement of Preliminary Issues' (7 November 2024) at [48].

⁴⁴ For example, Commerce Commission interview with [] (30 October 2024) Commerce Commission interview with [] (31 October 2024); Commerce Commission interview with [] (1 November 2024) and Commerce Commission interview with [] (25 October 2024). See also Electric Kiwi – 'Submission on Statement of Preliminary Issues' (7 November 2024) at [49].

⁴⁵ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at p 2.

in the future) in which baseload hedges may be able to act as close substitutes for Shaped.

68. PPAs are unlikely to be close substitutes for either baseload hedges or Shaped Hedges, given PPAs are generally generation following and have no certainty of supply.⁴⁶
- 68.1 For example, intermittent generators such as a wind farm typically offer PPAs as wind generation is unlikely to provide the certainty of supply that would allow the generator to provide specific risk management cover for particular volumes at particular times of the day. As such, it appears unlikely that a purchaser of baseload or Shaped Hedge would switch to a PPA in response to a price rise.
- 68.2 We do however note that PPAs that are backed by a flexible generation asset, such as flexible hydro generation, may be substitutable with Shaped Hedges to a degree, as the flexibility means that the generator could conceivably respond to price signals related to the spot price and produce more output during peak hours when prices are high. However, even in this instance PPAs may not provide as much security to customers as baseload or Shaped Hedges given PPA often do not contractually provide for certainty of supply.
69. There appear to be limited alternatives available for Shaped Hedges.
- 69.1 Potential alternatives to purchasing Shaped Hedges include buying battery capacity (stored energy that can be deployed when there are peaks); and demand responses (such as incentivising customers to use less power at certain times).
- 69.2 However, in its risk management review, the EA concluded that while batteries and demand responses might be close substitutes for Shaped Hedges from a technical perspective, they are all relatively new to the industry, so they might not yet be able to successfully discipline the prices of Shaped Hedges.⁴⁷ Further, industry participants told us that batteries are only capable of providing short-term flexibility (as we understand they are generally only able to store electricity for a few hours at a time) and are expensive to build.⁴⁸ We also understand that demand response may be harder for non-integrated retailers to enact as they have a smaller portion of industrial load than gentailers (ie, a smaller portion of load that can be turned off for longer time periods) and its success can depend on receiving ‘buy in’

⁴⁶ The EA also notes that PPAs are “relatively distant” substitutes for other risk management options. Electricity Authority – ‘Reviewing risk management options for electricity retailers – issues paper’ (7 November 2024) at Chapter 4, p. 5, at 2.9.

⁴⁷ Electricity Authority – ‘Reviewing risk management options for electricity retailers – issues paper’ (7 November 2024), p. 2.

⁴⁸ Commerce Commission interview with [] (31 October 2024), Commerce Commission interview with [] (7 November 2024) and Commerce Commission interview with [] (31 October 2024).

from customers.⁴⁹ As such, presently, neither batteries nor demand side management are likely to be close economic substitutes for Shaped Hedges, and we do not consider wholesale customers would switch sufficient purchases of Shaped Hedges to these alternatives such that it would make a price increase by a hypothetical monopolist unprofitable. However, as new technologies and strategies develop, batteries and demand response might become closer substitutes for Shaped Hedges in the future.

70. For completeness, our concerns around the Proposed Acquisition relate to the supply of Shaped Hedges, rather than the supply of PPAs and baseload hedges, which the Parties also overlap in. The numerous providers of both PPAs and baseload hedges would be able to act as a competitive constraint on the merged entity should it raise the price of any of these products post-Acquisition.

Supply side considerations in assessing different types of hedges

71. On the supply side, the evidence gathered to date suggests that there are some constraints on the ability of generators to supply each of the different types of hedge products. This constraint appears most relevant to the supply of Shaped Hedges.
- 71.1 Generators with flexible assets have the ability to supply a range of different hedge products.⁵⁰ For example, we understand that a hypothetical generator with flexible assets offering Shaped Hedges would likely be able to relatively easily switch to offering baseload hedges or PPAs in response to a price increase of these products.
- 71.2 However, we understand the reverse might not be true. A hypothetical generator currently offering baseload hedges and/or PPAs may not easily and quickly be able to start supplying Shaped Hedges in response to an increase in the price of Shaped Hedges because of type of generation assets they have.⁵¹ As the name indicates, generators with inflexible generation assets cannot alter their existing generation to make it more flexible – flexible generation either needs to be acquired or built. Further, we understand there are constraints on the ability of existing generators to develop new flexible assets to enable them to supply Shaped Hedges.⁵²

⁴⁹ Electricity Authority – ‘Reviewing risk management options for electricity retailers – issues paper’ (7 November 2024), at Chapter 4, [2.11] and [5.38(c)].

⁵⁰ For example, see Commerce Commission interview with [] (1 November 2024); Commerce Commission interview with [] (1 November 2024); Commerce Commission interview with [] (30 October 2024).

⁵¹ For example, see Commerce Commission interview with [] (7 November 2024), Commerce Commission interview with [] (11 November 2024). The EA also notes that as baseload generation must run consistently all the time, it is only suited to underwriting baseload contracts (Electricity Authority – ‘Reviewing risk management options for electricity retailers – issues paper’ (7 November 2024), Chapter 4, [6.4(b)]).

⁵² For example, see Commerce Commission interview with [] (1 November 2024) and Commerce Commission interview with [] (7 November 2024).

- 71.3 To this extent, it appears that, in response to a price increase of Shaped Hedges, only generators with flexible assets would have the ability to quickly and easily supply Shaped Hedges.

Geographic dimension

72. In line with Contact's submission about market definition, we consider that the appropriate geographic market for the supply of physical electricity, hedges, and Shaped Hedges, is national.
73. The physical electricity that Contact, Manawa and other generators produce and supply is governed by the Code.
- 73.1 The spot price reflects the matching of the supply of electricity from power stations with real-time consumption by households and businesses.
- 73.2 Generators producing electricity over a certain minimum volume are required to supply their electricity into the electricity system.
- 73.3 Transpower is the system operator and manages the electricity system so that electricity supply and demand is matched simultaneously.
- 73.4 Spot prices are determined via a process whereby Transpower chooses the cheapest combination of offers from generators to meet the demand for electricity.
- 73.5 The EA is responsible under the Code for monitoring participants in wholesale supply of physical electricity.
74. As this is all done on a national basis, we agree that the market for the wholesale supply of electricity is national.
75. Similarly, hedges are sold nationally – either on exchanges like the ASX or via bilateral negotiations between buyers and sellers.

Customer dimension

76. At this stage, we agree with Contact that we do not need to define separate markets for any particular customer group (retailers or C&I customers) when assessing wholesale market issues relating to the Proposed Acquisition. We consider that this assessment applies to physical electricity, hedges and Shaped Hedges.
- 76.1 All wholesale physical electricity is supplied by generators to the grid if their offers are accepted. As such, the price paid by retailers and C&I customers for physical wholesale electricity is the same, and generators cannot price discriminate between the two customer groups.
- 76.2 Although retailers and C&I customers appear to have different hedge requirements, this discrepancy seems to be closely related to their product requirements. For example, retailers tend to demand super-peak Shaped

Hedges more than C&I customers, because the latter do not tend to be exposed to high spot prices during morning and evening peaks.

77. Therefore, we consider assessing separate product markets for the supply of the main types of hedges will likely capture any differences in requirements between the main wholesale customers.

Summary of current approach to assessing the wholesale supply of electricity

78. Our current view is that defining the following wholesale markets would best isolate the key competition issues that are likely to arise from the Proposed Acquisition:

78.1 a separate national market for the wholesale supply of physical electricity; and

78.2 separate national markets for the supply of the main type of hedges (in particular Shaped Hedges).

79. We invite submissions on our current approach to assessing the supply of wholesale electricity and hedges, and for parties to provide us with further evidence of the scope of the relevant product dimension for assessing wholesale electricity products. In particular, we are interested in receiving submissions on:

79.1 how the pricing of the different hedging products compare with one another;

79.2 the extent to which retailers, C&I customers and generators switch between purchasing the different hedge products (particularly between Shaped Hedges and other products) and switch between purchasing electricity on the spot market and purchasing hedges;

79.3 the extent to which generators are able to switch between supplying different hedge products (particularly Shaped Hedges, and on an OTC and/or ASX basis);

79.4 the current and future supply and demand for the different hedge products (particularly Shaped Hedges) including the likely impacts of ASX Super-peak Hedges on supply and demand for hedges; and

79.5 the extent to which substitutes exist for Shaped Hedges, including to what extent (and when) the new investment in batteries and the development of demand response programs might be used by independent retailers and independent generators as substitutes for Shaped Hedges.

The market for the supply of retail electricity

80. Although the Proposed Acquisition will not result in aggregation in any retail market because Manawa does not currently supply electricity to retail customers, the retail dimension is important for our assessment of the potential for vertical effects from the Proposed Acquisition.

81. Contact submits that there is a national market for the retail supply of electricity to residential and SME customers.⁵³
82. In regard to assessing the product dimension, we agree with Contact that any retail product market would likely relate to the physical supply of electricity to mass market customers (being both residential and SME end users).⁵⁴
83. In addition to assessing competition at a national level, we are also considering whether it would be appropriate to define more granular regional geographic markets for the supply of physical electricity to residential and SME customers.
84. In the past the Commission has assessed both national and regional markets when considering overlaps in retail electricity markets, depending on the facts of the particular case.⁵⁵
- 84.1 The most recent assessment was in 2021 when the Commission assessed the potential impact of the proposed Mercury/Trustpower acquisition using 30 regional markets for the retail supply of electricity to mass market customers.⁵⁶
- 84.2 However, as part of that assessment the Commission also noted that the competitive dynamics in many of these regions were relatively similar except for the Tauranga region, which was highlighted as having different retail dynamics than others.⁵⁷
85. Given the above, we are considering whether it would be appropriate in this instance to define more granular regional markets for the supply of physical electricity to residential and SME customers.
86. We invite submissions on the most appropriate geographic market with which to assess the vertical effects of the Proposed Acquisition on the retail supply of physical electricity to residential and SME customers, including whether it is necessary to define any narrower regional markets.

With and without scenarios

87. Assessing whether a substantial lessening of competition is likely requires us to:
- 87.1 compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the merger, often referred to as the factual) with the likely

⁵³ The Application at [21.1]-[21.3]. Consistent with the Commission's approach in *Contact Energy Limited and Natural Gas Corporation Holdings Limited*, 2003 (Decision No. 491).

⁵⁴ For example, see Commerce Commission interview with [] (1 November 2024); Commerce Commission interview with [] (1 November 2024); Commerce Commission interview with [] (30 October 2024).

⁵⁵ *Contact Energy Limited and Natural Gas Corporation Holdings Limited*, 2003 (Decision No. 491); and Mercury NZ Limited and Trustpower Limited's retail business [2021] NZCC 16.

⁵⁶ Mercury NZ Limited and Trustpower Limited's retail business [2021] NZCC 16.

⁵⁷ Mercury NZ Limited and Trustpower Limited's retail business [2021] NZCC 16.

state of competition if it does not (the scenario without the merger, often referred to as the counterfactual); and

- 87.2 determine whether competition is likely to be substantially lessened by comparing that scenario. There may be more than one such scenario.

The factual

88. With the Proposed Acquisition:

88.1 Contact would acquire Manawa, and the electricity that Manawa currently generates/supplies, increasing Contact's share of New Zealand electricity generation; and

88.2 Manawa would cease to exist as an independent generator and wholesaler of electricity to retailers and large C&I end users.

The counterfactual – Contact

89. Contact submits that the status quo is unlikely to represent the relevant counterfactual for Contact, as due to the commissioning and decommissioning of various plants, its total generation output will increase in future while its flexibility will decrease. We agree with Contact's assessment of the appropriate counterfactual for Contact.

The counterfactual – Manawa

Views of Contact and Manawa

90. Contact submits that the most appropriate counterfactual for Manawa is the status quo, where Manawa continues to operate as an independent generator and wholesaler of electricity.⁵⁸ Contact further submits that, in the counterfactual:⁵⁹

90.1 it expects that Manawa would also continue to pursue its development pipeline, although the speed at which this would progress is uncertain; and

90.2 as the Mercury Hedge volumes begin to roll off, Contact expects the generation volumes would be contracted to parties with investment grade credit rating, which includes gentailers, commercial and industrial users and some independent retailers.⁶⁰

91. Manawa submits that – absent the Proposed Acquisition – it would
[⁶¹]:

⁵⁸ The Application at [13.2].

⁵⁹ The Application at [13.2].

⁶⁰ The Application at [13.2].

⁶¹ []

91.1 [];
62 and

91.2 []
].⁶³

92. Consistent with public statements, Manawa advised it would recontract the Mercury Hedge volumes as they roll off to support its ongoing development pipeline.
[]

].⁶⁴

93. Specifically in terms of the sale of Shaped Hedges in the counterfactual, Manawa submits that:

93.1 []
].⁶⁵

93.2 []
].⁶⁶
[]
].⁶⁷

93.3 []
].

⁶² The Application at [13.3] and Appendix 17 [].

⁶³ The Application at [13.3] and Appendix 17 [].

⁶⁴ The Application at Appendix 17 [].

⁶⁵ The Application at Appendix 17 []].

⁶⁶ The Application at Appendix 17 []].

⁶⁷ [].

68 []⁶⁹

93.4 []⁷⁰
[]⁷¹

94. However, []
Manawa has some generation flexibility in its hydro schemes⁷² and would likely follow signals relating to the spot price. As a result, it would be able to produce more electricity when prices are higher (during peak/super-peak times) and therefore any volume following contracts supplied to customers would reflect this.
[]

73

[] Accordingly, any customers entering into agreements with Manawa would likely receive some protection against high prices during peak/super-peak periods (which is the sort of protection sought from a Shaped Hedge).

Our current views

95. At this stage, we consider that, absent the Proposed Acquisition, Manawa would likely recontract the majority of the Mercury Hedge through long-term, generation following contracts with third parties. However, based on the evidence we have received to date, we consider that we cannot exclude the real chance that Manawa would supply some volume of Shaped Hedges to wholesale customers absent the

68 []

69 Commerce Commission interview with Manawa [()].

70 []

71 Commerce Commission interview with Manawa [()].

72 As noted by Manawa, its “existing assets are almost exclusively hydropower” (Manawa Energy FY24 Annual Results Presentation (20 May 2024)). This is consistent with previous statements it has a nationwide portfolio of flexible generation schemes. For example, see Trustpower – 2021 Trustpower Interim Results (30 September 2021).

73 Commerce Commission interview with Manawa [()].

Proposed Acquisition using the remaining Mercury Hedge volumes that are not contracted as long-term, generation following contracts.

96. In assessing what Manawa would likely do absent the Proposed Acquisition, the evidence tends to support submissions from the Parties that Manawa would look to recontract the majority of the Mercury Hedge volumes [] as generation following agreements (such as PPAs) with investment-grade parties.
- 96.1 In May 2023, a Manawa investment presentation mentioned that “Increasing portfolio length as Mercury hedge rolls off presents opportunity for new products in wholesale/C&I market.”⁷⁴
- 96.2 In May 2024, Manawa outlined that, as an independent generator, “Focusing on long-term, large volume offtake agreements for a significant portion of the portfolio is a lower risk contracting approach which allows for access to greater levels of debt to fund new developments”.⁷⁵
[]
- 96.3 When choosing which products to sell and to which counterparties, Manawa is likely to have a preference for long, low-risk (eg, PPA) hedges sold to creditworthy customers, because it can use them as collateral when raising debt for new investments. Manawa may also be particularly conscious of a potential customer’s creditworthiness given its experience with Prime Energy (an independent retailer that defaulted on its payments to Manawa in August 2024).⁷⁶
- 96.4 In this respect, there appears to be a real chance that Manawa would enter into OTC Hedge arrangements (namely long term PPAs) []
97. However, it is likely that, after entering into any long term PPAs, it would still have unsold generation []. There is some evidence to indicate that Manawa might have the ability and/or incentive to supply some of the unsold generation as Shaped Hedges.
- 97.1 The current Mercury Hedge is “shaped (volume and price) across time of day and across calendar quarters and is referenced to multiple nodes”.⁷⁷ This suggests it is likely to provide a shape that industry participants would find valuable, and that Manawa would be able to sustain a high level of supply of Shaped Hedges.

⁷⁴ Manawa Energy - FY23 Investor presentation (May 2023).

⁷⁵ Manawa Energy - FY24 Annual Results Presentation (20 May 2024).

⁷⁶ For example, see Electricity Authority ‘Working with Manawa Energy and Prime Energy to ensure managed resolution for customers’ (9 August 2024).

⁷⁷ Manawa Energy- FY25 Interim Results Presentation (8 November 2024) at p19.

97.2 []].

97.3 []].⁷⁸

97.4 Generators typically earn a premium from the sale of Shaped Hedges. For example, we estimate that the average (risk-adjusted) mark-up on Shaped Hedges (compared to baseload ASX Hedges) is approximately []].⁷⁹

97.5 Independent retailers stressed to the Commission their desire to purchase Shaped Hedges⁸⁰ and as set out earlier, their demand for such hedges is likely to increase in the foreseeable future.⁸¹

98. At this stage, we do not consider that we can exclude the real chance that Manawa would supply some volume of Shaped Hedges to third parties, absent the Proposed Acquisition. However, accurately assessing the likely volume of Shaped Hedges that Manawa would supply absent the Proposed Acquisition is difficult.

98.1 For example, the supply of Shaped Hedges to independent retailers to date has been relatively low. Between Q4 2022 and Q2 2024, we understand that independent retailers bought approximately [] of Shaped Hedges (peak and super-peak), which works out to approximately []].⁸²

98.2 However, our current estimates indicate that if, in the counterfactual, Manawa was to supply some of the unsold [] generation (after entering into long-term PPA agreements) as Shaped Hedges, this might represent a significant volume of the total supply of Shaped Hedges. For

⁷⁸ []

⁷⁹ Based on the EA's hedge request data covering Shaped Hedges sold to independent retailers between the fourth quarter of 2022 and the second quarter of 2024.

⁸⁰ For example, see Electric Kiwi - Submission in response to Statement of Preliminary Issues (7 November 2024), Commerce Commission interview with [] (30 October 2024), Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (31 October 2024).

⁸¹ As discussed above and outlined in Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024).

⁸² These estimates are based on our calculations using the EA's data on OTC Hedge requests made by independent retailers between Q4 2022 and Q2 2024. To calculate the total volume of Shaped Hedges sold in this period, we filtered the dataset to include only the peak and super-peak OTC Hedges bought by independent retailers and summed up the total volumes associated with this sample.

example, even if Manawa only sold 10% of its generation as Shaped Hedges, this would amount to 200,000MWh, or [] of the current total annual supply of Shaped Hedges to Independent Retailers (approximately []).

- 98.3 Further, in our view, the PPAs that Manawa would likely to sell in the counterfactual would be 'shaped'.

[

].

Consequently, we consider the PPAs that Manawa may sell in the counterfactual to be functionally similar to Shaped Hedges.

99. While we acknowledge the Parties' submissions that Manawa would not be a significant supplier of Shaped Hedges in the counterfactual, we cannot rule out that it would not supply some volume of Shaped Hedges given Manawa's [] and the increasing value of this product. Even small volumes of Shaped Hedges supplied by Manawa may have a big impact on the supply of these products.
100. For the purposes of this Sol, we therefore assess the Proposed Acquisition against a counterfactual where Manawa sells some portion of its generation as Shaped Hedges (or PPAs with similar functional characteristics) to electricity retailers, independent generators, or gentailers. In terms of the possible volume of that supply:
- 100.1 We understand that generators with flexible assets such as Manawa do not typically hedge 100% of their generation and retain some buffer between the electricity they generate and the electricity volumes committed to hedges.
- 100.2 As such, at this stage we consider an appropriate starting point when considering the portion of its generation that Manawa would sell as Shaped Hedges would be to use an estimate of approximately 10-15% of its generation.⁸³ We use this estimate in our analysis below.
101. For completeness, we are not considering whether the issues around access to Shaped Hedges raised by industry participants and the EA would be resolved with Manawa supplying some portion of Shaped Hedges absent the Proposed Acquisition. Instead, we are considering whether the removal of Manawa would likely result in a substantial lessening of competition in the relevant markets. We discuss this further in our competitive effects assessment section below.

⁸³ That is, we consider that in the counterfactual Manawa is unlikely to offer a de minimis level of its uncontracted volume as Shaped Hedges but also that it is unlikely to offer a large proportion of its uncontracted volume as Shaped Hedges.

102. We invite submissions on:
- 102.1 the level of premium Shaped Hedges attract (particularly compared to baseload ASX Hedges);
 - 102.2 generators' incentives to sell Shaped Hedges – currently and in the foreseeable future;
 - 102.3 the volume of Shaped Hedges Manawa might be likely to sell in the counterfactual; and
 - 102.4 the extent to which the PPAs that Manawa may sell in the counterfactual – as discussed above – would be functionally similar to Shaped Hedges from the perspective of customers.

Vertical effects – supply of Shaped Hedges

Introduction

103. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical effects. This can occur where a merger gives the merged entity a greater ability and/or incentive to engage in conduct in a market that raises rivals' costs in a related market or prevents or hinders rivals from competing effectively in that market (which we refer to as "foreclosing rivals").⁸⁴ Foreclosure strategies can include refusing to supply competitors an important input that is essential for them to compete (total foreclosure) or raising the price it charges competitors to access that input or reducing its quality (partial foreclosure).
104. Our approach to assessing whether vertical effects are likely to arise from the Proposed Acquisition is to consider whether:
- 104.1 the merged entity has the ability to foreclose competitors through:
 - 104.1.1 having market power at one or more levels of the supply chain; and
 - 104.1.2 having a mechanism through which to raise the costs of its rivals in a related market;
 - 104.2 the merged entity has the incentive to foreclose competition (because it is more profitable to foreclose than to continue to supply those rivals in the same way); and
 - 104.3 the lost competition from the foreclosure amounts to a substantial lessening of competition.
105. Given the differentiated nature of hedge types, channels and customers, there are, in theory, several foreclosure strategies available to the merged entity. We currently consider that partial or total input foreclosure of independent retailers and

⁸⁴ Mergers and Acquisitions Guidelines above n5 at [5.1]-[5.15].

independent generators with respect to the supply of Shaped Hedges is the most plausible or likely to adversely affect competition in one (or more) of the relevant markets.

- 105.1 Foreclosure target – we consider that a hypothetical foreclosure strategy could target both independent retailers and independent generators. As set out in the counterfactual section, Manawa’s internal documents indicate [].⁸⁵ Foreclosing rival gentailers appears less plausible because all of them have some access to generation flexibility and could – to some extent – gain protection against volatile prices during peak trading periods through their own generation.
- 105.2 Foreclosure product scope – according to retailers, Shaped Hedges appear to be less readily available to customers than other contractual arrangements, such as PPAs or baseload hedges.⁸⁶ Further, Shaped Hedges are sold only by a small number of generators, mostly gentailers.⁸⁷ As such, foreclosure in relation to Shaped Hedges is more likely to adversely affect customers than potential foreclosure strategies targeting other products.
- 105.3 Foreclosure type – Shaped Hedges appear to be important inputs for both independent retailers and independent generators (see the section on ability to foreclose below). In our competitive assessment of vertical effects we therefore consider a potential input foreclosure theory of harm, whereby the merged entity forecloses independent retailers and independent generators in relation to the supply of Shaped Hedges.
- 105.4 Foreclosure mechanism – it is unclear whether refusing to supply Shaped Hedges, raising prices or worsening the terms of Shaped Hedges would be more plausible. There are currently no regulations forbidding generators from withholding Shaped Hedges from retailers or generators. What is more, Shaped Hedges are typically traded on the OTC basis (via bilateral negotiations), so the merged entity would have the ability to change the prices of its Shaped Hedges.⁸⁸ As such, all foreclosure mechanisms appear available to the merged entity. We therefore consider all foreclosure mechanisms in our competitive assessment.

⁸⁵

[].

⁸⁶ Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (31 October 2024).

⁸⁷ According to the EA hedge request data, between the fourth quarter of 2022 and the second quarter of 2024, only [] supplied any Shaped Hedges to independent retailers.

⁸⁸ We understand that peak hedges (a type of Shaped Hedges) can also be traded on the ASX, but – according to market participants – peak hedges are not frequently traded via this exchange. As set out in the section on the expected future changes to the electricity industry super-peak hedges (another type of Shaped Hedges) are now available to trade on the ASX, although the effect of this change on the potential foreclosure mechanisms considered in this section is currently unclear.

106. At this stage, we consider that the Proposed Acquisition raises concerns that the merged entity would have the ability and incentive to use its market power in the supply of Shaped Hedges to foreclose both rival electricity retailers and generators, and that such conduct could substantially lessen competition.
107. A substantial lessening of competition may arise where foreclosure makes entry and expansion more difficult, or otherwise reduces a competitor's (or competitors') ability to provide a competitive constraint. Foreclosure does not need to force a competitor, or competitors, to exit the market to have this effect.⁸⁹ In this situation, either total or partial foreclosure could result in a substantial lessening of competition by reducing retailers' or generators' abilities to provide a competitive constraint and/or affect their abilities to enter and expand. This is because restricting access to Shaped Hedges exposes retailers and generators to greater spot price volatility and high spot prices, meaning they are less likely to be able to be price competitive to their respective customers.

Ability to foreclose rival electricity retailers or generators

108. In general, a firm is likely to hold market power in a given market if it can set its prices above its marginal cost for a sustained period of time, acting – to some extent – independently of constraints, such as rivals, customers or regulation. For a firm to have the ability to foreclose its customers it must therefore have market power. Conversely, if a firm's market power is limited because of the threat of new entry and other competitive constraints, it would be unlikely to have that ability.

Views of the Applicant

109. The Applicant submits that the merged entity would not have the ability to foreclose rivals in the supply of Shaped Hedges (or any types of contracts). This is because, according to Contact:⁹⁰

109.1 the merged entity's assets would be largely inflexible, and its share of flexible generation would be low. Contact submits that its flexible assets are limited to thermal plants which are aging and which have a high risk of fuel supply, and that Manawa's assets are small, geographically diverse, and have limited flexibility. Contact also estimated flexibility of generation across the four gentailers and Manawa, by calculating – for each hydro plant it considered in the sample – the maximum hydro storage capacity and the amount of annual hydro inflows (in GWh) to plants with seasonal storage capabilities.⁹¹ On both measures – hydro storage capacity and hydro inflows – the merged entity's flexibility would be lower than Meridian, Mercury, and Genesis;⁹²

⁸⁹ Mergers and Acquisitions Guidelines above n5 at [5.10].

⁹⁰ Letter received from Bell Gully on behalf of Contact Energy (3 December 2024).

⁹¹ Maximum hydro storage reflects the maximum volume of a reservoir in million m³. Hydro inflows reflect the average volume of water entering a main catchment in a week. Each is converted to GWh using the effective power (a measure of efficiency) of each hydro plant.

⁹² The Application at Figure 15 and Figure 16.

- 109.2 new flexible assets, which are capable of supporting the supply of Shaped Hedges, are currently being built. Contact identified that WEL (a new potential entrant), Meridian, Contact and Genesis have either started building or commissioned investments in grid scale batteries. Contact also notes that other suppliers, like Mercury, NZ Clean Energy, Ethical Power, and Kea-X, are investigating buying grid scale batteries, and that Contact is exploring a ‘virtual battery’ service model, whereby it could contract out this capacity to other parties; and
- 109.3 demand-side innovations – such as better control of end-consumers’ hot water to reduce peak demand – could be an effective substitute for Shaped Hedges.
110. However, some of Contact’s internal documents relating to the Proposed Acquisition []⁹³
111. Manawa’s data appears to suggest that it has a large degree of generation flexibility. Manawa identified [] which accounts for approximately [] of Manawa’s generation.⁹⁴

Our current view

112. To assess the merged entity’s ability to foreclose rivals’ access to the supply of Shaped Hedges, we have considered the:
- 112.1 merged entity’s market power in the supply of Shaped Hedges;⁹⁵
- 112.2 importance of Shaped Hedges to independent retailers and independent generators; and
- 112.3 any regulations around the supply of Shaped Hedges.
113. At this stage, we are not satisfied that the merged entity would not have the ability to foreclose rivals in the supply of Shaped Hedges.

⁹³ [].

⁹⁴ Commerce Commission analysis of response to request for information from Manawa (18 October 2024).

⁹⁵ For completeness, we consider that even if Shaped Hedges are not a separate market in and of themselves, they may represent such an important aspect of the market for the supply of hedges overall that a lessening of competition in the supply of Shaped Hedges to independent retailers and generators may nevertheless lessen competition in the market for the supply of hedges.

The merged entity is likely to have market power in the supply of Shaped Hedges

114. To assess the degree of the merged entity's likely market power in the supply of Shaped Hedges, we have estimated:
- 114.1 its share of total supply of Shaped Hedges. This analysis provides information about the relative sizes of suppliers offering this type of contracts and can be a useful proxy of suppliers' market power; and
 - 114.2 its degree of generation flexibility. Suppliers who sell Shaped Hedges face a risk that spot prices will be high at times covered by such contracts, which is why only wholesalers with some generation flexibility offer Shaped Hedges. We would expect that the extent of suppliers' generation flexibility will provide useful information about suppliers' market power with respect to the supply of Shaped Hedges.
115. To estimate the merged entity's share of supply of Shaped Hedges, we have used the data collected and processed by the EA for the purpose of its issues paper on risk management options for electricity retailers.⁹⁶ This dataset contains information on requests by independent retailers for both the buying and selling of OTC Hedges (including Shaped Hedges) between the fourth quarter of 2022 and the second quarter of 2024.⁹⁷ From this dataset, we have identified and analysed a subset of [] requests which resulted in Shaped Hedges (peak and super-peak) being sold to independent retailers.⁹⁸
116. In Table 1 below, we set out the share of supply of Shaped Hedges based on the methodology outlined above. The table shows the number and proportion of Shaped Hedge requests won by each supplier as well as the level and proportion of committed electricity.

⁹⁶ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024).

⁹⁷ Including hedge shape (eg, baseload, peak, super-peak etc), contract start and end date, identity of interested parties, information on whether a contract was awarded, identity of the winner, volume obligations, strike price, and the strike price of a corresponding ASX benchmark product.

⁹⁸ As set out above, we consider the merged entity's potential foreclosure of independent retailers and independent generators. While the EA's dataset on OTC Hedge requests that we analyse in this section includes the hedges traded by generators and independent retailers, it does not include hedges bought by independent generators. Whilst including these hedges in our assessment would likely change the number of wins and volumes committed by generators listed in Table 1, it is less clear whether the relative share of generators would be affected.

Table 1: Share of supply of Shaped Hedges, Q4 2022 to Q2 2024

Supplier	Number of wins	Share of wins	Volume of committed electricity (MWh)	Share of committed electricity (MWh)
Contact	[
Manawa				
<i>Merged Entity</i>				
Mercury				
Genesis				
Meridian]
Total	[]	100%	[]	100%

Source: EA. Note: figures do not exactly sum to 100% due to rounding.

117. Based on our estimates,
[

].

118. In terms of volume of committed electricity,
[

].

119. According to the EA data,
[

119.1

99

119.2

];¹⁰⁰ and

119.3 a 2,000GWh pa Shaped Hedge sold to Mercury as part of Mercury's acquisition of Trustpower retail business in September 2021.¹⁰¹

120. We therefore consider that [] not indicative of Manawa not being an active supplier of Shaped Hedges.

121. [] would mean that Manawa's share of supply of this product would be [] and the

⁹⁹ Letter received from A&B Competition Lawyers on behalf of Manawa Energy (6 December 2024) at [21]-[24].

¹⁰⁰ Letter received from A&B Competition Lawyers on behalf of Manawa Energy (6 December 2024) at [21]-[24].

¹⁰¹ The Application at [13.2].

merged entity's [] Genesis' [] and Meridian's [] Mercury's [].¹⁰²

122. Further, we consider that in the counterfactual, Contact's and Manawa's relative size in the supply of Shaped Hedges would likely increase because:

122.1 Mercury's share of supply of Shaped Hedges (and therefore the extent of its market power) is likely to decline as the Mercury Hedge rolls off.

122.2 [].¹⁰³

122.3 However, we note that [

].¹⁰⁴

123. To further assess market power in the supply of Shaped Hedges, we have also considered generators' access to flexible electricity generation. This is because the ability to provide Shaped Hedges is generally linked to having assets with the ability to produce flexible generation (as these generators can increase or decrease the generation they produce in order to provide a 'shape'). We would therefore expect that any generator that has control of a material proportion of flexible electricity generation would as a result have market power in the supply of Shaped Hedges.

124. We are not aware of any industry standard to measure the level of asset flexibility. We have therefore considered two approaches.

125. First, MDAG (a group established to advise the EA) identified the difference between the 95th and the 5th percentile of generation distribution of a given plant as a measure of its flexibility.¹⁰⁵ The basis for this is that in principle, a plant with a wide distribution of electricity generation in a given period is likely to be more flexible than a plant whose output does not vary as much. We expect that any supplier with market power in the supply of Shaped Hedges would need to have a relatively wide distribution of electricity generation.

126. In line with this approach and based on the generation data provided by the Parties and available on the EA's website, we have calculated the distribution of electricity generation for each gentailer as well as for Manawa and the merged entity. Data for Manawa was provided by Manawa. We have considered daily, weekly, and monthly

¹⁰² We do not include Manawa's Shaped Hedge to Mercury in this calculation because the EA data on hedge requests discussed in this section is limited to hedges traded with independent retailers.

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¹⁰⁴ Letter received from A&B Competition Lawyers on behalf of Manawa Energy (6 December 2024) at [2] and [18].

¹⁰⁵ <https://www.ea.govt.nz/documents/1253/Competition-analysis-FINAL-v2.pptx>.

generation distributions to see whether a generator’s flexibility differs across different timeframes. Table 2 below sets out the difference between the 95th and 5th percentiles of generation distribution (in MWh, for daily, weekly and monthly generation) for the selected generators.

Table 2: Difference between the 95th and 5th percentiles of generation distribution, MWh, 3 October 2021 – 25 February 2024

Supplier	Day	Week	Month
Contact	8,357	146,078	218,863
Manawa	5,372	51,464	127,529
<i>Merged Entity</i>	11,785	195,528	330,334
Meridian	14,181	246,842	353,216
Mercury	9,831	153,163	225,196
Genesis	10,882	130,253	261,155

Source: Commission’s calculations based on EA’s and Manawa’s generation data.

127. Based on our assessment:

127.1 Contact’s asset flexibility is currently the lowest among the gentailers on a short-run (daily) basis (as proxied by interpercentile range for daily generation), third on a medium-run basis (weekly generation) and lowest on a long-run basis (monthly generation);

127.2 Manawa’s asset flexibility is lower than all the gentailers on short-run, medium-run and long-run bases;

127.3 The merged entity would become the second largest supplier of flexible generation on short, medium and long-run bases;

127.4 Of the gentailers, Meridian has the highest generation flexibility in the short, medium and long-run bases before the Proposed Acquisition. After the Proposed Acquisition, Meridian retains the highest generation flexibility. This is consistent with Contact’s view that Meridian has the largest fleet of flexible assets;¹⁰⁶

127.5 Mercury has the second lowest generation flexibility among gentailers in the short and long-run and second highest in the medium run. We consider that Mercury’s [] and its relatively low flexibility of assets may be connected to the fact that it currently has access to Shaped Hedges provided by Manawa which it can on-sell; and

127.6 Genesis has the second highest generation flexibility among gentailers in the short and long term and the lowest flexibility in the medium-term.

128. Based on this analysis, it appears that, as a result of the Proposed Acquisition, Contact’s generation flexibility is likely to improve materially. After the merger, the

¹⁰⁶ The Application at [28.8].

merged entity would have access to the second most flexible asset fleet in the short, medium and long-run, behind only Meridian.

129. We acknowledge that in the future with the Proposed Acquisition, the distribution of the merged entity's generation might be different to the modelled values in the table, as the merged entity would need to optimise the generation of both Manawa's and Contact's assets (instead of each party optimising their own production). It is not clear whether this would lead to a wider or narrower distribution of output.
130. Secondly, we have considered shares of supply of physical wholesale electricity based on the volume generated in flexible assets only. We understand from gentailers and from the EA's issues paper on risk management products that thermal and hydro storage plants tend to be the most flexible assets, because they can be used to adjust output relatively easily.¹⁰⁷ We also understand from MDAG's report on moving to a renewables-based electricity system that thermal plants are likely to be retired in the near future with hydro storage plants becoming the key source of generation flexibility.¹⁰⁸ Consequently, we have calculated the share of supply of generation from flexible hydro plants as well as from the combination of flexible hydro and thermal plants based on the typical annual generation of each plant as published by the EA (last modified in May 2023).^{109 110} Our results are shown in Table 3 below.

¹⁰⁷ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 3, [3.4].

¹⁰⁸ Market Development Advisory Group – 'Price discovery in a renewables-based electricity system' (11 December 2023) p. 35.

¹⁰⁹ Source: EA dataset '20151030_ExistingGenerationPlant.xls', available at <https://www.emi.ea.govt.nz/Wholesale/Datasets/Generation/GenerationFleet/Existing>. As this dataset excludes plants beyond 2015, we cross checked the flexible plants we included against the Application, the merging parties RFI responses, and the file '20230601_DispatchedGenerationPlant.csv' (available at the same link as above) which contains more recent plant data, but no data on hydro storage or annual generation.

¹¹⁰ Flexible plants were identified through two processes. Firstly, thermal plants were identified by having a generation type of 'thermal' and a fuel type relating to coal, gas, wood waste, biogas or diesel. Secondly, flexible hydro was identified where the plant met at least one of the following conditions: the dataset identified the plant as having hydro storage, the Application's discussion of generators' flexible assets at [28.8]-[28.11] identified flexibility at, or upriver, of the hydro plant, RFI responses by Contact and Manawa on each's flexible assets identified the plant as having medium – long term flexibility, or, for any remaining plants with average generation exceeding 100GWh, desktop research identified the extent to which each had flexibility.

Table 3: Average electricity generation and share of supply from flexible assets

Supplier	Hydro storage only		Hydro storage and thermal	
	Volume (GWh)	Share of volume (%)	Volume (GWh)	Share of volume (%)
Contact	3,660	16.3%	6,219	19.8%
Manawa	1,250	5.6%	1,276	4.1%
<i>Merged Entity</i>	<i>4,910</i>	<i>21.9%</i>	<i>7,495</i>	<i>23.9%</i>
Meridian	12,120	54.1%	12,120	38.7%
Mercury	3,970	17.7%	4,370	13.9%
Genesis	1,402	6.3%	6,997	22.3%
Other	0	0.0%	350	1.1%
Total	22,402	100%	31,332	100%

Source: Commission's calculations based on EA and Manawa data.

Note: figures do not exactly sum to 100% due to rounding.

131. Based on this assessment, we have found that:

131.1 Meridian has by far the largest proportion of flexible generation with 54% of the total flexible hydro generation and 39% of the combined flexible hydro and thermal generation in New Zealand.

131.2 The merged entity would become the second most flexible generator with 22% of the total flexible hydro generation and 24% of the combined flexible hydro and thermal generation, followed by Mercury (with an 18% and 14% share, respectively) and Genesis (with a 6% and 22% share, respectively).

132. The relative sizes of generators based on this analysis are broadly consistent with the assessment of interpercentile ranges set out above. In particular, both analyses indicate that Meridian has the largest asset flexibility and that currently Contact has some asset flexibility, but lower than its rival gentailers'. It appears that Mercury's and Genesis' asset flexibility differs depending on the methodology.

133. We acknowledge that Contact, in its Application, obtained different results regarding generators' flexibility than the results we set out above in this section. This is because Contact assessed generators' flexibility based on hydro storage capacity and hydro inflow data, whereas our approach includes interpercentile range analysis and shares of generation supplied from flexible hydro and thermal plants.¹¹¹ Currently, we consider that Contact's approach has certain limitations which may underestimate generation flexibility of some generators.

133.1 Contact appears to have excluded from its analysis hydro plants with medium-term (allowing shifting output across weeks) flexibility.¹¹² We

¹¹¹ The Application at [28.6] – [28.12].

¹¹² We understand that the main difference between our sample and that used by Contact, in relation to Manawa's flexible hydro plants, relate to Manawa's Matahina and Mangahao plants, which our dataset identifies as having hydro storage, [].

understand such plants can also be used to underwrite Shaped Hedges and, as such, should be included in a generation flexibility analysis.

- 133.2 Flexibility of some hydro plants considered by Contact may be underestimated. This is because Contact appears to have estimated hydro storage capabilities and hydro inflows of a plant based on the hydrological environment in direct proximity of the plant without fully considering the hydrological environment upstream. In some cases, a plant may have little storage capabilities or hydro inflows if it is situated on a river, but may have more storage capabilities or hydro inflows in a lake upstream. This appears to be the case, among others, for the Roxburgh plant which is downstream of Contact's storage reservoir at Lake Hawea.
134. Overall, our assessment of the merged entity's potential market power in the supply of Shaped Hedges suggests that:
- 134.1 Contact is currently one of the three material suppliers of Shaped Hedges to independent retailers (together with Meridian and Mercury). Manawa is currently not a material supplier of Shaped Hedges to independent retailers, but – as discussed in the counterfactual section – we consider that there is a realistic chance that absent the merger it would replace, at least partially, the 2,000GWh Mercury Hedge with a similar product sold to independent retailers (or independent generators). Even if Manawa replaced only a small fraction of the volumes previously committed to Mercury with Shaped Hedges sold to independent retailers or generators it would likely become one of the biggest suppliers of Shaped Hedges.
- 134.2 The merged entity would have the second most flexible generation among gentailers behind Meridian, both in terms of its overall production and in terms of its output from hydro storage.
135. We are therefore currently of the view that the merged entity may have market power in the supply of Shaped Hedges, meaning it may have the ability to foreclose rival independent retailers and independent generators.
136. We also currently consider that the merged entity's market power is likely to grow in the future because:
- 136.1 the demand for Shaped Hedges by independent retailers and independent generators is expected to grow materially, as more intermittent energy is added into the electricity network (which we discuss above in the section on expected future changes to the industry); and
- 136.2 the supply of flexible hydro assets is not expected to increase. Rather, based on the EA's investment pipeline data, we understand that between 2024 and 2030, only 326GWh of hydro generation (flexible and inflexible) might potentially be built, which amounts to less than 0.1% of electricity generation

in 2024.¹¹³ Moreover, the data indicates that one third of the planned hydro investments are considered by Manawa and Contact.

Shaped Hedges are an important input for rivals

137. The evidence suggests that Shaped Hedges, and in particular hedges that provide cover for super-peak periods, are an important input for independent retailers and generators in order to successfully compete. As outlined earlier, peak hedge products provide risk management cover during the day and super-peak hedge products provide risk management cover during morning and evening peaks when demand is typically the highest.¹¹⁴
- 137.1 Independent retailers need Shaped Hedges in order to better manage risks around spot price volatility during the periods of high demand, which in turn allows them to be more competitive on price and therefore compete more successfully for customers. One retailer told us that access to Shaped Hedges is fundamental for an independent retailer's success, and that unless you can procure these types of risk management tools the retailer will not be price competitive.¹¹⁵ Another retailer told us that Shaped Hedges are critical because retailers cannot be totally exposed to peaks.¹¹⁶
- 137.2 The importance of risk management products for competition was also noted in the EA's review of risk management options for electricity retailers.¹¹⁷ With generation in the electricity industry becoming more intermittent, the EA expects the capacity to provide Shaped Hedge contracts will become increasingly scarce as a greater proportion of generation will require firming to meet demand.¹¹⁸ At the same time, greater price volatility in the market will increase demand for Shaped Hedges to manage this risk.¹¹⁹
- 137.3 For completeness, we have not yet tested with independent retailers or independent generators about ASX Super-peak Hedges as this product had not been announced at the time of our initial market enquiries.
138. Independent generators – unlike independent retailers – benefit from periods of high spot prices, because they can sell their physical electricity at a higher price. As such, they do not require a financial product, such as Shaped Hedges, to protect them from high spot prices at peak times.

¹¹³ Based on the generation figures set out in the Application at Figure 9.

¹¹⁴ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024), Chapter 1 FN 3.

¹¹⁵ Commerce Commission interview with [] (31 October 2024).

¹¹⁶ Commerce Commission interview with [] (31 October 2024).

¹¹⁷ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024).

¹¹⁸ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 3 [6.2].

¹¹⁹ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 3 [6.4].

- 138.1 However, independent generators may require firming products (such as Shaped Hedges) to complement other types of contracts (eg, PPAs) they sell to their customers, especially if their assets are intermittent, eg wind or solar farms.
- 138.2 This is because some customers are reluctant to buy PPAs from independent generators if they are not complemented by a firming element.¹²⁰ Without firming, customers purchasing PPAs based on intermittent generation might be exposed to high prices during the periods of adverse weather (little wind of sun). Firming gives customers a fuller protection against spot price volatility compared to PPAs, because the latter do not contain any volume obligations. It appears that almost all of the generation expected to be built by independent generators in the future is from intermittent sources.¹²¹ Independent generators may therefore rely on Shaped Hedges to compete effectively in the supply of hedges to independent retailers and C&I customers.^{122 123}
- 138.3 We therefore consider that the availability of Shaped Hedges is likely to be a factor that generators, including potential entrants, consider when deciding whether to invest in new assets.
139. We understand that independent retailers in particular are currently struggling to get access to these Shaped Hedges, or access at a competitive price.¹²⁴ One retailer told us that it has experienced the most challenges in obtaining super-peak hedges.¹²⁵ Another retailer told us that sourcing Shaped Hedges is “constantly” a problem and that ideally it would be able to source cover for all the peaks to fit its customers’ demands.¹²⁶

¹²⁰ Commerce Commission interview with [] (11 November 2024) and Commerce Commission interview with [] (18 November 2024).

¹²¹ According to the EA’s data, 98% of electricity generation expected to be built by independent generators by 2030 would be based on intermittent sources.

¹²² We note that at least one independent generator sells PPAs without the accompanying firming. However, that generator targets customers with a stable energy consumption profile, such as C&I customers. The same generator told us that, to cater to customers who demand more energy during peak times, it would require Shaped Hedges. Commerce Commission interview with [] (7 November 2024).

¹²³ Batteries can also be a source of firming for independent generators but they can only provide protection against spot price volatility within a day, whereas Shaped Hedges can span across several years. As such, independent generators might not always be able to use batteries to firm their intermittent output if their access to Shaped Hedges deteriorated.

¹²⁴ For completeness, this does not mean that independent generators are able to access these products satisfactorily, but rather that at this stage, we understand that these products are less critical to an independent generators’ ability to be competitive and are as a result demanded less by these market participants. For example, see Commerce Commission interview with [] (31 October 2024), Commerce Commission interview with [] (30 October 2024), Commerce Commission interview with [] (25 October 2024) and Commerce Commission interview with [] (31 October 2024).

¹²⁵ Commerce Commission interview with [] (31 October 2024).

¹²⁶ Commerce Commission interview with [] (31 October 2024).

140. As we discuss earlier, products or strategies which could be used by independent retailers and independent generators instead of Shaped Hedges – such as baseload hedges,¹²⁷ battery capacity (stored energy to be deployed when there are peaks),¹²⁸ and demand responses (such as incentivising customers to use less power at certain times)¹²⁹ – are currently not particularly close substitutes for Shaped Hedges. As such, the merged entity’s potential foreclosure strategy would likely be unconstrained by the availability of substitutes of Shaped Hedges.
141. Finally, the importance of Shaped Hedges for independent retailers and independent generators is likely to grow in the future. As set out in the section on the expected future changes to the industry, the increasing generation of intermittent energy and retiring of thermal assets is likely to increase spot price volatility, therefore making Shaped Hedges more important tools for retailers’ and generators’ risk management.

Regulation of the supply of Shaped Hedges

142. As set out earlier, as of January 2025, standardised super-peak hedges are able to be sold on the ASX. Peak Hedges can also be traded on the ASX.
143. However, there are currently no market-making obligations on generators that would mandate their supply of Shaped Hedges on the ASX – or via any other means. We also understand that there are currently no regulations around the volume or price of the Shaped Hedges sold by generators.

Conclusion on the merged entity’s ability to foreclose

144. At this point, we are not yet satisfied that the merged entity would not have the ability to foreclose the supply of Shaped Hedges to independent retailers and independent generators, regardless of whether Shaped Hedges are in a separate product market or are part of a broader product market. This is because:
- 144.1 the merged entity may have market power in the supply of Shaped Hedges;
 - 144.2 the merged entity’s market power is likely to be materially larger than Contact’s, thereby granting it greater ability to foreclose its customers in relation to the supply of Shaped Hedges;
 - 144.3 Shaped Hedges are an important input for independent retailers and independent generators with few viable substitutes; and
 - 144.4 there are currently no regulations mandating the supply of Shaped Hedges by generators, and that as such the merged entity would be able to withhold

¹²⁷ One retailer told us that if it cannot secure peak supply at fair prices it will purchase a bit more baseload in the hopes that it will provide some benefit to peak exposure (Commerce Commission interview with [] (31 October 2024)).

¹²⁸ Commerce Commission interview with [] (31 October 2024).

¹²⁹ This could also include a retailer either deciding not to grow their customer book or trying to offload customers. One retailer told us that this was the most economically efficient move in response to it being unable to secure the types of hedges it would like (Commerce Commission interview with [] (31 October 2024)).

supply of these products post-Acquisition or worsen the terms of their supply for purchasers.

145. We invite submissions on:

- 145.1 the extent to which the merged entity would have market power for the supply of Shaped Hedges;
- 145.2 how flexible Manawa's assets are;
- 145.3 our approach to assessing the merged entity's market power for the supply of Shaped Hedges;
- 145.4 the extent to which rival gentailers might be able to increase their supply of Shaped Hedges in response to a potential foreclosure by the merged entity;
- 145.5 whether Shaped Hedges are an important input for independent retailers and independent generators;
- 145.6 whether there are any other means of potential foreclosure the merged entity could employ;
- 145.7 to what extent demand for, and supply of, Shaped Hedges is likely to increase in the next five to 10 years; and
- 145.8 any likely impact ASX Super-peak Hedges might have on the merged entity's ability to foreclose rivals.

Incentive to foreclose rival electricity retailers or generators

146. A firm would only rationally foreclose competitors if it is profitable to do so. We would expect the merged entity to have an incentive to foreclose if the potential gains from foreclosing the supply of Shaped Hedges to independent retailers and independent generators are likely to outweigh the potential losses.

Views of the Applicant

147. Contact considers that the merged entity would not have the incentive to foreclose independent retailers and independent generators by refusing to supply Shaped Hedges because there are effective substitutes for Shaped Hedges (such as grid scale batteries and demand response) and because capacity for these substitutes is growing rapidly due to low barriers to implementation.¹³⁰ Contact also submits that, as anticipated by MDAG, this part of the market is likely to become more competitive, rather than less.¹³¹

¹³⁰ Letter from Bell Gully on behalf of Contact (3 December 2024) p. 4.

¹³¹ Letter from Bell Gully on behalf of Contact (3 December 2024) p. 5.

Our current view

148. To assess the merged entity's incentive to foreclose rivals' access to the supply of Shaped Hedges, we consider the likely costs and gains that the merged entity might incur from such a potential strategy.
149. At this stage, we are not satisfied that the merged entity would not have the incentive to foreclose rivals in the supply of Shaped Hedges.

Potential costs of foreclosure

150. A firm will only rationally foreclose competitors if it is profitable to do so, ie, if the expected profits of foreclosure outweigh the expected loss of revenue from foreclosure.
151. If the merged entity was to foreclose rivals in the supply of Shaped Hedges, the only costs it would likely incur would be related to the foregone profits from the hedges it would otherwise sell to these customers. As we note previously, there are currently no regulatory requirements to supply Shaped Hedges.
152. The merged entity's foregone profits from the sales of Shaped Hedges can be calculated based on the following revenues and costs of supplying such contracts.
- 152.1 The revenue generated from supplying Shaped Hedges (the strike price of such contracts – that is the agreed price for one MWh of electricity covered by the contract) is the relevant metric of revenue from the supply of Shaped Hedges.
- 152.2 There are no production costs associated with selling a Shaped Hedge. Instead, by selling a Shaped Hedge a generator incurs an opportunity cost of not selling a quarterly baseload ASX Hedge (which is an option always available to generators). To account for locational and shape risk differences between the Shaped Hedge and the baseload ASX Hedge, the latter's price needs to be appropriately adjusted.¹³² The adjusted strike price of the baseload ASX Hedge products corresponds to the opportunity cost of selling a Shaped Hedge.
- 152.3 The difference between the strike price of the Shaped Hedge and the risk-adjusted price of the baseload ASX Hedge is therefore the profit a supplier makes by selling a Shaped Hedge.
153. Based on the EA's data on OTC Hedge sales, we have identified [] instances of Contact selling Shaped Hedges (peak and super-peak) to independent retailers between the fourth quarter of 2022 and the second quarter of 2024. Using this data,

¹³² To compare the prices of baseload ASX Hedges and Shaped Hedges on a like-for-like basis, one needs to adjust the price of baseload ASX Hedges to reflect its different locational and shape risk. Locational risk refers to the fact that spot prices may differ across nodes. To account for these risks, we have followed EA's methodology set out in its risk management review issues paper. See Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) Appendix A.

we have estimated that the volume-weighted mean premium on Contact's Shaped Hedges (over and above the risk-adjusted baseload ASX price) sold to independent retailers amounts to approximately [].

154. Given that the average unit price for a quarterly baseload ASX Hedge (across all quarters between Q1 2025 until Q4 2028) was at \$157.50 as of 4 December 2024, Contact would expect to make on average approximately [] per MWh in profit from selling 1MWh in the form of a Shaped Hedge.¹³³
155. As set out in the counterfactual section, we consider that absent the Proposed Acquisition Manawa may consider selling some of the [] of its generation as Shaped Hedges.
[]
[]. Given this and absent exact information about the volume of Shaped Hedges that Manawa might sell in the counterfactual, for the purpose of this exercise we assess the merged entity's costs of foreclosure based on an assumption that, in the counterfactual, Manawa might contract out 10-15% of its generation as Shaped Hedges. This would amount to approximately [] annually.
156. Based on this assessment, we have produced a high-level estimate which indicates that, the merged entity might forego between [] in profits per year if it was to refuse to sell the volume of Shaped Hedges which Manawa would have sold in the counterfactual. The actual profits at risk might be lower (higher) if the price of baseload ASX Hedges or Contact's premium on Shaped Hedges were to decline (increase) in the future.
- 156.1 In theory, all available information (including agents' expectations about the future) affecting the price of baseload ASX Hedges should be already priced in. Therefore, the current price of baseload ASX Hedges appears to be the best estimate of their future price.
- 156.2 It is unclear how Contact's premium on Shaped Hedges might change in the future. On the one hand, by removing Manawa, the supply of Shaped Hedges might decline. This increased scarcity might allow Contact to charge higher prices on Shaped Hedges. On the other hand, the introduction of ASX Super-peak Hedges might increase the supply of Shaped Hedges from Contact's rivals, potentially driving down Contact's prices. We therefore consider Contact's current premium on Shaped Hedges to be a good estimate of its future premium.
157. If, instead of refusing to sell Shaped Hedges, the merged entity was to increase their price, it would likely sell a positive volume of such contracts at a higher premium. Whether the expected foregone profits from the merged entity raising prices of Shaped Hedges would be higher or lower than from the refusal to sell such contracts

¹³³ The level of unit profit that a generator would expect to make is the premium of risk-adjusted Shaped Hedges over and above baseload ASX Hedge prices. The premium of a Shaped Hedge is calculated as the mean and median difference between a Shaped Hedge and a comparable baseload ASX Hedge.

depends on their price elasticity of demand. We have not yet estimated this elasticity and we welcome submissions commenting on its potential value in assessing the incentive of the merged entity to foreclose its rivals.

Potential gains from foreclosure

158. We consider there are two potential sources of gains that the merged entity might make as a result of foreclosing Shaped Hedges from independent retailers and independent generators.

158.1 First, to the extent that the offering of independent retailers deteriorates after the potential foreclosure, some customers of independent retailers might choose to switch to the merged entity, therefore increasing its profits from supplying retail electricity.¹³⁴

158.1.1 Based on profitability data of Contact's retail arm, we estimate the merged entity could expect to make [] per MWh. Throughout a year each connection uses approximately [] MWh. Therefore, over the course of a year we may expect each new connection to generate a profit of [].¹³⁵

158.1.2 If the merged entity was to foreclose only [] – and all of their customers were to switch to rival retailers proportionately to their current market shares, then the merged entity would gain [] connections. This produces a high-level estimate of [] in annual profit. This gain might be larger if the merged entity was able to increase its retail prices following the foreclosure of independent retailers. Conversely, the gain would be lower if not all of [] customers decided to switch away.

158.2 Second, by foreclosing independent generators, the merged entity might deter independent generators (including new entrants) from building new assets. This is because independent generators – who are most likely to build wind and solar plants – are likely to require firming products (such as Shaped Hedges) to supply customers with protection against fluctuations in spot

¹³⁴ Most of the independent retailers that we interviewed told us that they would expect the merged entity to sell lower volumes of OTC Hedges than Contact and Manawa would separately, absent the merger. For example, see Commerce Commission interview with [] (31 October 2024); Commerce Commission interview with [] (30 October 2024); and Commerce Commission interview with [] (31 October 2024)). See also Electric Kiwi 'Submissions on the Contact/Manawa Clearance Application' (7 November 2024) at [5(e)].

¹³⁵ Retail profit per MWh of [] is the sum of Contact's gross profit from retail operations divided by the volume of electricity sold by Contact's retail arm. Annual volume per connection of [] is the average monthly volume of electricity sold by Contact's retail arm divided by the average monthly number of ICP connections, multiplied by 12. The annual profit per ICP connection of [] is the product of the retail profit per MWh and annual volume per ICP connection. Contact's retail profit is calculated by subtracting its energy costs, network charges, meter rental costs and market levies from its revenues. These calculations use Contact's monthly data over the period July 2021 to October 2024 and have been annualised.

prices during the times when their plants are not able to generate electricity. If, as a result of the merged entity's hypothetical foreclosure, investment in new supply decreases or slows down, the average spot price is likely to increase. As shown in Figure 2 (in the section on temporal output optimisation), it appears that after the merger, the merged entity's exposure to the spot market might be between [] of its generation. Given the combined annual output of Contact and Manawa in 2023 is around 10,000,000 MWh, each \$1 increase in the average spot price would result in an annual gain between []. At this stage it is unclear whether – or how much – the merged entity's potential foreclosure might affect the level of the spot price.

159. At this stage, we are not satisfied that the merged entity would not have the incentive to foreclose independent retailers and independent generators. Even a small increase in the level of spot price of \$6/MWh – a 3% increase relative to the average spot price of \$200 in 2024¹³⁶ – from the potential foreclosure could, by itself, provide the merged entity with sufficient gains to outweigh the potential foreclosure costs.¹³⁷ Combined with potential gains from the retail arm, the total gain from a potential foreclosure strategy might exceed its cost.
160. We invite submissions on:
- 160.1 our approach to assessing the incentives of the merged entity to foreclose its rivals;
 - 160.2 to what extent the merged entity would be constrained by the supply of Shaped Hedges offered by rival gentailers;
 - 160.3 the types and values of costs and gains that the merged entity might incur if it was to foreclose its customers with respect to the supply of Shaped Hedges;
 - 160.4 the extent to which lower levels of investments in new assets might affect the spot price for wholesale electricity; and
 - 160.5 any likely impact the new ASX Super-peak Hedge product might have on Contact's incentive to foreclose rivals.

Adverse effect on competition

161. The ultimate question is whether the competition lost from potentially foreclosed competitors is sufficient to have the likely effect of substantially lessening

¹³⁶ Based on a daily average across Upper North Island, Central North Island, Lower North Island, Upper South Island, and Lower South Island. See: https://www.emi.ea.govt.nz/Wholesale/Reports/W_P_C?DateFrom=20240101&DateTo=20241231&RegionType=ZONE&TimeScale=DAY&WeightedBy=SIMPLE&rsdr=Y1&si=v|3

¹³⁷ A \$6 increase in the spot price might provide the merged entity with gains between \$[] million (if merged entity's exposure to the market is []%) to \$[]million (if it is []%) a year. This range exceeds the potential annual costs of foreclosure from not supplying Shaped Hedges which Manawa would have sold in the counterfactual (which we estimate to range between []).

competition in light of the remaining constraints in the relevant market(s). We are still assessing this point and have not reached any conclusions in this regard.

162. First, we are considering the competitive constraint that the likely targets of the merged entity's potential foreclosure strategy – independent retailers and independent generators – currently place on the merged entity and other rivals. To the extent that this constraint is material, the loss of competition from rival foreclosure is likely to be substantial.

162.1 Based on the EA's issues paper on risk management options for retailers, it appears that independent retailers have historically been an important source of innovation in the retail supply of electricity.¹³⁸ The EA found that in the last 10 years medium sized retailers were overrepresented relative to their market share, with innovations from these retailers classed as "disruptive", "architectural" and "radical" (which were the classifications used by the EA to categorise the innovations it assessed), even though in 2023 they only held 15% of the retail supply.¹³⁹ It therefore appears that independent retailers are an important competitive force, despite their smaller size.

162.2 In the 2024 financial year, independent generators accounted for approximately 8% of all electricity generation.¹⁴⁰ However, going forward they are expected to be the main source of investment in new generation. According to Transpower's data, independent generators are likely to build [] of new generation equating to [] of new capacity.¹⁴¹ As such, they are also likely to become an important competitive force in the future.

163. Second, we are considering whether there are any counterstrategies that rivals could employ to defeat the foreclosure (for example, vertical integration of independent retailers with independent generators, independent retailers switching their suppliers of other types of hedges from the merged entity to other generators or switching to a greater reliance on batteries). At this stage of our investigation, it is unclear that any effective counterstrategies exist. For example:

163.1 there are only a small number of existing independent generators. Many of the new entrant generators are intermittent, meaning any vertical integration of independent retailers with these generators would not help with the supply of Shaped Hedges (as we set out earlier, flexible generation is commonly required to supply Shaped Hedges, and most intermittent

¹³⁸ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 2 Table 1.

¹³⁹ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 2 [4.8(c)] and Table 1.

¹⁴⁰ The Application at Figure 9. If we exclude Manawa from this share, then independent generators accounted for approximately 4% of annual generation in the 2024 financial year.

¹⁴¹ Based on expected values, that is probability of investment being completed times generation/capacity. Response to request for information from Transpower (2 December 2024).

generation is not flexible) and intermittent generation does not typically match the demand profile required by independent retailers;¹⁴²

- 163.2 based around what we have heard about Shaped Hedges being in short supply, it is not clear that a retailer would be able to easily acquire these products from another gentailer; and
- 163.3 lastly, as we set out earlier, batteries are an incomplete substitute for Shaped Hedges as they are only able to provide short-term flexibility and are currently in their infancy due to the costs of implementation.
164. At this stage, we therefore cannot rule out that any potential foreclosure strategies undertaken by the merged entity might result in a material reduction in competition in retail or wholesale supply of electricity.
165. For completeness, we are not considering whether the issues around access to Shaped Hedges raised by industry participants and the EA would be resolved with Manawa supplying some portion of Shaped Hedges absent the Proposed Acquisition. Instead, we consider whether the removal of Manawa would likely result in a substantial lessening of competition in the relevant markets. In particular, with respect to the supply of Shaped Hedges:
- 165.1 we understand that the supply of Shaped Hedges is currently limited, and is likely to get smaller in future (regardless of the merger) as the supply of flexible assets decreases; and
- 165.2 because the volatility of the spot price is likely to increase in the future (see the section earlier on the expected future changes to the industry), the importance of Shaped Hedges to customers exposed to the spot price – and therefore demand for Shaped Hedges – is likely to increase in the future.
166. Consequently, in the supply of Shaped Hedges, where competition may be already subdued and may become more muted in the future, even a relatively small decrease in supply of such contracts may adversely affect competition.
167. We invite submissions on:
- 167.1 the level of constraint that independent retailers provide to gentailers, and across what aspects of competition (for example, in terms of price, service levels, innovation or investment);
- 167.2 the level of constraint independent generators are likely to provide to gentailers in the future;
- 167.3 the likely effect any manner of foreclosure would have on competition, and the extent to which any effect on competition would be substantial; and

¹⁴² Electricity Authority – ‘Reviewing risk management options for electricity retailers – issues paper’ (7 November 2024) at Chapter 4 [5.4(c)].

167.4 whether there are any strategies rivals could employ to defeat attempted foreclosure strategies by the merged entity.

Unilateral effects – supply of Shaped Hedges

Introduction

168. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profit by reducing quality or increasing price.¹⁴³
169. As discussed earlier, Shaped Hedges are an important risk management product for independent retailers and generators, and the ability for a generator to offer these products is dictated by the amount of flexible generation assets a generator has. We consider that Shaped Hedges are in a separate product market from other types of hedges. As set out in the vertical effects section, we consider that the merged entity would be likely to have some market power in the supply of Shaped Hedges given it would have the second largest fleet of flexible assets.
170. In this unilateral theory of harm, we therefore consider whether the merged entity would be able to engage in a strategy that would allow it to profitably increase the cost to retailers and generators of acquiring Shaped Hedges or worsen the terms on which they are provided.
171. At this stage, we are not yet satisfied that the Proposed Acquisition would not give rise to unilateral effects for the supply of Shaped Hedges.

Views of the Applicant

172. Contact submits that the Proposed Acquisition will likely increase the volume of hedges the merged entity can offer the market, due to the increased certainty of generation the complementary nature of Contact's and Manawa's portfolios would provide.¹⁴⁴
173. Contact submitted a report from Frontier Economics which explores the complementary nature of its and Manawa's assets in more detail.¹⁴⁵ In the report, Frontier used actual plant generation data from 2001-2023 to test the degree to which the electricity production of Contact and Manawa's hydro plants are negatively correlated. Frontier used the results of this analysis to calculate the theoretical uplift in the supply of OTC Hedges and physical supply contracts sold at fixed prices if Contact was to acquire Manawa.
174. According to Frontier's analysis, the merged entity could offer 3-26% more OTC Hedges compared to the benchmark.¹⁴⁶

¹⁴³ Mergers and Acquisitions Guidelines above n5 at [3.62].

¹⁴⁴ The Application at [27.22]-[27.25].

¹⁴⁵ The Application at Appendix 1.

¹⁴⁶ The Application at Appendix 1 [Table 6] & [Table 9].

175. According to Contact, it will be highly motivated to offer more OTC Hedges to reduce its exposure to spot prices and provide revenue certainty.¹⁴⁷ Contact says that this will improve its competitiveness in sales to retailers and commercial and industrial customers, and allow it to offer more contracted sales, especially longer-term sales, which will provide its customers with increased certainty.¹⁴⁸ Contact submits that the increase in the number of OTC Hedges available will increase competition in downstream markets.¹⁴⁹
176. Contact also submits that the Proposed Acquisition will not materially impact competition for storage and shaped/firming products (those which can flex to respond to particular demand) as these are a small part of Contact and Manawa's portfolios (especially as thermal generation is retired).¹⁵⁰
177. Generators with flexible generation (such as stored water in hydro schemes) have greater ability to provide physically firm and/or shaped products. Contact submits that as most of Contact and Manawa's hydro assets are 'run of river' (ie, there is little to no ability for water to be stored) the Parties do not have a substantial amount of assets with medium to long term flexibility (flexibility across week and months, respectively) and that there is therefore unlikely to be any effect on concentration levels in this area following the acquisition.¹⁵¹

Our current view

178. We have received mixed evidence on whether Contact and Manawa currently compete closely for the supply of Shaped Hedges:¹⁵²

178.1 In a Manawa internal document

[

153

].

178.2 []¹⁵⁴ []

178.3 We understand from EA hedge request data that

[

¹⁴⁷ The Application at [27.10] and [27.14].

¹⁴⁸ The Application at [27.3].

¹⁴⁹ The Application at [27.3].

¹⁵⁰ The Application at [28.1]-[28.18].

¹⁵¹ The Application at [28.5]-[28.6].

¹⁵² We recognise that we have no evidence on whether Contact and Manawa currently compete for the supply of ASX Super-peak Hedges as this product is in its infancy.

¹⁵³ []

¹⁵⁴ Responses to request for information from Manawa (11 October 2024) and Contact (16 December 2024).

].¹⁵⁵

178.4 [,] and retailers told us they have a general inability to source Shaped Hedges from Contact.¹⁵⁶

179. As set out earlier in the counterfactual section, we currently consider that absent the Proposed Acquisition, there is a real chance that Manawa would supply some volume of Shaped Hedges.

180. However, we have received mixed evidence on whether Contact and Manawa might compete closely in the supply of Shaped Hedges in the future.

180.1 We consider that the strongest argument for potential future competition between Contact and Manawa in the supply of Shaped Hedges is that the two have sufficient flexible assets to allow them to provide these products.

180.1.1 As we set out earlier at Table 3, Contact and Manawa both have some flexible assets, particularly on medium- and long-term bases (within a week and month respectively).¹⁵⁷ Despite Contact submitting that Manawa does not have much asset flexibility, [

].¹⁵⁸ As flexible assets are key for providing Shaped Hedges, we consider that absent the Proposed Acquisition, Contact and Manawa could compete closely for the supply of these products to independent retailers and generators.

180.1.2 While Manawa has the smallest share of flexible assets of all the generators, it has large volumes of generation that it will be free to sell as Shaped Hedges once the volumes become available. We understand that, on an annual basis, the size of the Mercury Hedge is [] the size of the volumes of Shaped Hedges sold to independent retailers by generators.¹⁵⁹ Manawa might therefore be more incentivised to compete harder to allocate these volumes as they become available.

180.1.3 [] (and we understand that independent generators have a

¹⁵⁵ Based on EA hedge request data.

¹⁵⁶ For example, see Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (30 October 2024).

¹⁵⁷ While Contact submits that Manawa's hydro assets have little to no ability for water to be stored, we disagree with this assertion given our understanding of Manawa's generation portfolio. For example, in an RFI response Manawa identified that [] of its hydro assets have medium to long term flexibility (response to request for information from Manawa (18 October 2024)).

¹⁵⁸ []

¹⁵⁹ Based on EA hedge request data.

stronger incentive to sell hedges than gentailers as they do not have a retail arm to prioritise the hedging of), making Manawa a relevant counterparty for retailers, and different to gentailers. Retailers noted that Manawa is better placed to supply Shaped Hedges than other independent generators due to its portfolio (which is made up of some flexible hydro assets whereas the majority of other independent generators have assets that only provide baseload supply).¹⁶⁰ Another retailer told us that Manawa is the most significant independent generator in the market with experience in providing hedges, and that it is difficult to enter into hedging relationships with other independent generators that may have a single renewable plant due to the associated volatility of generation.¹⁶¹

180.2 Independent retailers we spoke with told us that Manawa is often easier to negotiate the supply of hedges with than a gentailer (and we anticipate this ease would extend to the supply of Shaped Hedges absent the Proposed Acquisition).¹⁶² We expect this to be because Manawa does not have a retail arm to supply hedges to (with Trustpower having sold this to Mercury in 2022). It may be that this independence means that it would in the future be able to act as a constraint on Contact and other gentailers, by being an important alternative for customers in negotiations for Shaped Hedges (although we note that there is currently mixed evidence around the extent to which Manawa would supply these products absent the Proposed Acquisition, which would impact the amount of constraint it could provide).

180.3 Several independent retailers told us that they hoped to be able to access some of the volumes Manawa had contracted to Mercury as these volumes became available.¹⁶³ However:

180.3.1 one retailer told us that generally the bigger generators have more capacity to offer Shaped Hedges;¹⁶⁴ and

¹⁶⁰ For example, see Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (25 October 2024).

¹⁶¹ Commerce Commission interview with [] (30 October 2024).

¹⁶² Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (25 October 2024). Another retailer noted that there is a “solid symbiosis” between an independent retailer and an independent generator (Commerce Commission interview with [] (30 October 2024). This retailer also noted that the loss of an independent Manawa would be the loss of a “very strategic partner”. Another retailer told us that the relationship with Manawa is “different” and more of a partnership (Commerce Commission interview with [] (31 October 2024). The retailer also noted that Manawa is unique as it values independent retailers, and that the removal of Manawa would remove the support for independent retailers.

¹⁶³ Commerce Commission interview with [] (30 October 2024); Commerce Commission interview with [] (31 October 2024); Commerce Commission interview with [] (25 October 2024) and Commerce Commission interview with [] (31 October 2024).

¹⁶⁴ Commerce Commission interview with [] (31 October 2024).

180.3.2 some retailers told us that Manawa’s willingness to provide Shaped Hedges has decreased (even prior to the Proposed Acquisition) and that Manawa has not helped with the supply of Shaped Hedges for the last two years.¹⁶⁵

180.4 We have seen internal documents from Manawa noting that []¹⁶⁶ although later internal documents suggest that []¹⁶⁷.

180.5 Manawa told us that its future strategy []¹⁶⁸.

180.6 Further, we understand that [] Manawa’s future investment products are for renewable, intermittent generation. The variable nature of these assets means that Manawa’s ability to offer Shaped Hedges will [] as a result of these assets and may indicate that providing such products is [] for Manawa.

181. The context is relevant in assessing this evidence. There is broad agreement that Shaped Hedges are going to be increasingly scarce, putting upward pressure on prices. It follows that buyers will increasingly be seeking competing offers. Against this context, it seems likely that Contact and Manawa would compete closely in the future for the supply of Shaped Hedges, absent the Proposed Acquisition.

182. As industry participants and the EA have identified, Shaped Hedges are harder to access than other forms of hedges.¹⁶⁹ While Manawa alone will not remedy the competition concerns around the supply of Shaped Hedges, Manawa supplying even a small amount of Shaped Hedges is likely to have a positive impact on competition. That these hedges would be backed by independent generation, versus hedges from the vertically integrated gentailers, is also likely to improve competition. Our concern

¹⁶⁵ Commerce Commission interview with [] (31 October 2024); Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (30 October 2024).

¹⁶⁶ [].

¹⁶⁷ []].

¹⁶⁸ [].

¹⁶⁹ See Electricity Authority – ‘Reviewing risk management options for electricity retailers – issues paper’ (7 November 2024); Submission from Electric Kiwi on Statement of Preliminary Issues (7 November 2024), Commerce Commission interview with [] (31 October 2024), Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (30 October 2024).

is therefore that, in a market where competition is already muted, and the future supply of Shaped Hedges is expected to be shrinking (in absolute and relative terms), the loss of even a small amount of competition for Shaped Hedges may be sufficient to result in a substantial lessening of competition.

183. As set out earlier in the vertical effects section, the merged entity is likely to have market power in the supply of Shaped Hedges as, among other reasons, it would have the second most flexible generation.
184. We are not currently satisfied that the remaining competitive constraints on the supply of Shaped Hedges would exercise sufficient constraint on the merged entity.
- 184.1 Post-acquisition, the only suppliers of Shaped Hedges would be gentailers, each with the demands of their own retail arms to fulfil. As we set out earlier if the merged entity was to raise the price of the Shaped Hedges it offers, or reduce supply of these products, it is not clear that rival gentailers would be willing or able to increase their supply of Shaped Hedges to independent retailers in response. This is because price is only likely to be one factor that affects the supply of these products, and factors such as the generator's overall hedging (including its particular risk management strategy) is likely to play more of a role in whether or not to offer these products.
- 184.2 New entry of sufficient scale to provide effective constraint is also highly unlikely, given there are limited new flexible assets available, especially assets that would produce sufficient quantities of Shaped Hedges to meaningfully respond to a price increase by the merged entity. For example, we understand that:
- 184.2.1 there is limited ability for new flexible hydro assets to be established as rivers and lakes are already under ownership¹⁷⁰ and carbon-producing flexible thermal assets are being retired due to a move towards decarbonisation;¹⁷¹ and
- 184.2.2 batteries are only capable of providing short-term flexibility (as we understand they are generally only able to store electricity for a few hours at a time) and are expensive to build.¹⁷² The EA notes that batteries are not suitable for running for longer periods of time, which would be necessary for firming intermittent generation.¹⁷³ The

¹⁷⁰ Commerce Commission interview with [] (7 November 2024)).

¹⁷¹ The Application at [11.1(d)].

¹⁷² Commerce Commission interview with [] (31 October 2024), Commerce Commission interview with [] (7 November 2024) and Commerce Commission interview with [] (31 October 2024).

¹⁷³ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 4, [5.42(c)].

EA also notes that batteries are currently only in the early stages of development in New Zealand.¹⁷⁴

- 184.3 Independent retailers and generators do not appear to have countervailing power which would constrain any proposed price rise or reduced supply of Shaped Hedges by the merged entity.¹⁷⁵ For example, independent retailers cannot self-supply Shaped Hedges and are unlikely to purchase sufficient quantities of Shaped Hedges to be able to sponsor new generator entry. Further, the Proposed Acquisition would remove an important alternative outside option for independent retailers and generators to negotiate with, which would reduce their negotiating power.¹⁷⁶
185. Finally, we are not persuaded that the Frontier Economics report is conclusive that post-Acquisition the merged entity would offer more hedges due to complementarities in the Parties' combined portfolio. While we agree with Frontier that there is some connection between confidence in producing a certain amount of generation and the amount of hedges a gentailer is willing to offer, we do not consider that this is the only relevant consideration, or that the former will necessarily always result in the latter. For example, we also think that factors such as vertical integration (in that a gentailer will naturally prioritise supply of Shaped Hedges to its retail arm over supply of these products to other parties),¹⁷⁷ the gentailer's particular risk management strategy and the type of assets it owns (including how flexible these are) are also relevant considerations.¹⁷⁸
186. We also note that many independent retailers that we spoke with told us that they would expect the merged entity to sell lower volumes of hedges than Contact and

¹⁷⁴ Electricity Authority – 'Reviewing risk management options for electricity retailers – issues paper' (7 November 2024) at Chapter 4, [2.7].

¹⁷⁵ For example, one retailer told us it is an "absolute price taker" and that it is very constrained where it can source hedges from (Commerce Commission interview with [] (30 October 2024) and another retailer noted that while it is "constantly" trying to purchase shape products from generators, there is a continued refusal to supply or constructive refusal to supply (Commerce Commission interview with [] (30 October 2024). In addition, see Electric Kiwi - Submission in response to Statement of Preliminary Issues (7 November 2024).

¹⁷⁶ One retailer noted that multiple counterparties are needed to be able to negotiate on price (Commerce Commission interview with [] (30 October 2024) and a submission from MEUG noted that the loss of Manawa would also reduce the number of counterparties large consumers can negotiate with when seeking new contracts or renegotiating contracts moving forward (MEUG submission on Statement of Preliminary Issues (7 November 2024) at [10].

¹⁷⁷ One retailer told us that vertically integrated gentailers "definitely" favour their retail arm (Commerce Commission interview with [] (25 October 2024), another told us that by not supplying hedges to retailers gentailers retain the status quo of significant market power (Commerce Commission interview with [] (31 October 2024) and a third said that a core issue in the industry is that gentailers hedge their own retail customer base first (Commerce Commission interview with [] (30 October 2024).

¹⁷⁸ Commerce Commission interview with the [] (16 October 2024), Commerce Commission interview with [] (1 November 2024), Commerce Commission interview with [] (1 November 2024).

Manawa would separately, absent the merger.¹⁷⁹ Several of these retailers noted that gentailers have an incentive to hedge their own customer base before selling hedges to retailers they compete with at the retail level.¹⁸⁰

187. We invite submissions on:
- 187.1 the impact on competition if Manawa was to sell some volume of Shaped Hedges to independent electricity retailers or generators;
 - 187.2 the extent to which Manawa is or may become an important supplier of Shaped Hedges;
 - 187.3 the extent to which Contact and Manawa currently compete for the supply of Shaped Hedges;
 - 187.4 the extent to which Contact and Manawa might compete for the supply of Shaped Hedges in the future, absent the Proposed Acquisition;
 - 187.5 the extent to which Manawa acts as a constraint on gentailers in their supply of Shaped Hedges;
 - 187.6 factors affecting gentailers' incentives to offer Shaped Hedges, including how profitable these products are; and
 - 187.7 the extent to which the response from existing competitors, new entry or the countervailing power of customers would be sufficient to act as a constraint on the merged entity.

Unilateral effects – market for the wholesale supply of physical electricity

188. In this unilateral theory of harm, we consider whether the merged entity would be able to engage in a strategy that would allow it to profitably increase the average level of electricity spot prices.
189. Spot prices are determined via a process whereby Transpower (as the system operator) chooses the cheapest combination of offers from generators to meet the demand for electricity. In some cases, demand in a given trading period and node cannot be met without supply from a single generator. In these circumstances the generator becomes 'gross pivotal'.

¹⁷⁹ For example, see Commerce Commission interview with [] (30 October 2024); Commerce Commission interview with [] (25 October 2024), Commerce Commission interview with [] (31 October 2024) and Commerce Commission interview with [] (31 October 2024). See also Electric Kiwi -Submission in response to Statement of Preliminary Issues (7 November 2024) p. 2 and Oji Fibre Solution - Submission in response to Statement of Preliminary Issues (7 November 2024) p. 2.

¹⁸⁰ Commerce Commission interview with [] (31 October 2024), Commerce Commission interview with [] (25 October 2024) and Commerce Commission interview with [] October 2024).

190. A gross pivotal supplier would become 'net pivotal' if, in addition to the electricity system requiring at least some of its supply, its net hedging position would incentivise the supplier to withhold some supply or raise its offered prices.
191. Even if a generator is not gross or net pivotal, its actions might affect the level of the spot price. Any supplier removing (adding) volumes priced at below-clearing level would lead to the spot price going up (down).
192. In our assessment of this theory of harm, we have been considering:
- 192.1 how the frequency of the merged entity's gross and net pivotality is likely to change after the merger, compared to Contact's pivotality currently;
- 192.2 whether, after the merger, the merged entity is likely to have greater ability and/or incentive to engage in strategies resulting in higher spot prices at times when it is not gross or net pivotal; and
- 192.3 whether the EA's monitoring and enforcement powers would be likely to prevent the merged entity from increasing spot prices (either at times when it is gross/net pivotal or not).

Gross and net pivotality

Views of the Applicant

193. In the Application, Contact explains that a gross pivotal generator has the ability to unilaterally increase electricity spot prices by limiting electricity supply to the market.¹⁸¹ According to Contact, the EA has previously considered whether a supplier is gross pivotal in assessing that supplier's ability to increase spot prices.¹⁸²
194. Contact submits (and we agree) that a gross pivotal generator may or may not profit from higher electricity spot prices, depending on the relative volume of generation and its net hedge position.
- 194.1 To the extent that a gross pivotal supplier holds a 'long' position, ie, its output exceeds its sales commitments in the form of hedges, it would become a 'net pivotal' supplier and would profit from higher electricity spot prices. That supplier would have an incentive to use its gross and net pivotal position to increase electricity spot prices.¹⁸³
- 194.2 If a gross pivotal supplier holds a 'short' position, meaning its output is lower than its sales commitments in the form of hedges, it may still profit from higher electricity spot prices in the long run if the elevated spot price affects forward electricity prices (and therefore suppliers' profits from hedges).

¹⁸¹ The Application at [26.7]

¹⁸² The Application at [26.6].

¹⁸³ The Application at [26.9].

Contact argues that only a supplier who is gross pivotal for a significant portion of the year might profit from this strategy.¹⁸⁴

195. Contact submitted analyses assessing the frequency and extent of Contact's and the merged entity's gross and net pivotality.¹⁸⁵ These analyses were conducted by Concept Consulting – Contact's advisors – and were based on historical data (covering the period from the year ending October 2020 to the year ending October 2022) containing trading period-level information about suppliers' output offers, consumers' bids, actual volumes and actual prices. This data was supplemented by Contact's and Manawa's hedge data. Based on these inputs, Concept analysed the frequency and size (or pivotal depth) of both Contact and the merged entity's gross and net pivotality.
196. In addition, Concept submitted a sensitivity analysis, which considered the effects of excluding 'must-run' generation from the gross pivotality analysis. This is Contact's preferred approach to measuring gross pivotality as it considers output cannot be withheld from some 'must-run' plant types (eg, geothermal or wind farms).
197. Based on that analysis, Concept concluded that, in the considered period:
- 197.1 Contact was gross pivotal in 20-25% of all trading periods, whereas the merged entity would have been gross pivotal 35-40% of the time.¹⁸⁶ The combined entity also has a deeper gross pivotal position; the merged entity would be gross pivotal by more than 500MW for 15% of the period compared to only 5% for Contact acting alone;¹⁸⁷
- 197.2 if must-run assets are excluded from the analysis, Contact's frequency of gross pivotality would be approximately 3-6%, whereas the merged entity's would be approximately 5-15%;¹⁸⁸ and
- 197.3 neither Contact nor the merged entity were found to have been net pivotal in any trading period.
198. Based on these results, Contact considers that the merged entity would have no incentive to increase prices when it is gross pivotal because:¹⁸⁹
- 198.1 in the periods when it is gross pivotal, its pivotal depth is low, which would require the merged entity to withdraw a large level of volume (and forego a material portion of its revenue from spot trading) before it could take advantage of its gross pivotal position;

¹⁸⁴ The Application at [26.11].

¹⁸⁵ The Application at Appendix 2 (Concept Consulting – Gross pivotal analysis – updated report (7 November 2024)).

¹⁸⁶ Concept Consulting – Gross pivotal analysis - updated report (7 November 2024) at Figure 1.

¹⁸⁷ Concept Consulting – Gross pivotal analysis - updated report (7 November 2024) at Figure 3.

¹⁸⁸ Concept Consulting – Gross pivotal analysis - updated report (7 November 2024) at Figure 1.

¹⁸⁹ The Application at [26.22]-[26.23].

- 198.2 reducing output by such volumes would substantially reduce revenue;
- 198.3 Contact would likely be unable to meet its contractual demands;
- 198.4 a large proportion of the merged entity's generation is from must-run assets whose output cannot be easily withheld; and
- 198.5 reducing output may be against trading conduct rules which might be detected and result in disciplinary action by the EA.
199. Finally, Contact considers that the frequency of the merged entity's gross and net pivotality in the near future is likely to be consistent with Concept's simulated frequency based on the historical data.¹⁹⁰ According to Contact, [
- 199.1
- 199.2
-].

EA analysis of Concept's report

200. In order to test the analysis put forward by Concept on behalf of Contact, we asked the EA to comment on Concept's assumptions, re-run Concept's gross and net pivotality analyses based on its own data and compare its output to Concept's. The results of this are summarised below.
- 200.1 The EA agreed that all of Concept's assumptions used in its gross and net pivotality analyses are reasonable.¹⁹¹ In particular, the EA agreed that, in principle, a gross pivotal supplier is unlikely to restrict output from must-run

¹⁹⁰ Letter from Bell Gully on behalf of Contact (30 October 2024), q 12.

¹⁹¹ These assumptions are as follows. 1) Removing offers from Contact Energy's Taranaki Combined Cycle Gas Turbine (TCC) and its now-retired Te Rapa cogeneration. 2) Adding in offers representing Tauhara (150MW baseload) and Te Huka upgrade (50MW baseload). 3) Leaving overall system supply/demand balance largely as it was, meaning there should not be a systemic increase or decrease in instances of gross pivotal. 4) All wind generation is treated as must-run in "Must-Run" scenario. 5) All geothermal generation is treated as must-run in "Must-Run" scenario. 6) 105MW must-run at Contact's Roxburgh station. 7) 24.5MW must-run at Meridian's Manapouri station. 8) 31MW at Meridian's Waitaki station. 9) 15MW at Mercury's Aratiatia station. 10) 39MW at Mercury's Karapiro station. 11) Not modelling any Manawa plant as must-run. 12) Not modelling 70MW minimum generation limit for Contact's Clyde station. 13) Setting pivotal price of \$40k/MWh for peripheral generation and \$30k/MWh for all other. 14) Remove ramping related constrained-on situations. 15) Remove market constraints that affect modified offers. 16) Using gross pivotality depth can overestimate the net pivotality (having incentive to price up).

assets to increase spot prices because generators typically seek to ensure all must-run generation is dispatched by offering it at a low price. This is because it might be costly and time-consuming to switch off and on a plant if its generation is not dispatched (eg, a geothermal plant) or it would involve foregoing a dispatch of energy produced at zero marginal cost (eg, wind farms). The EA also agreed with Concept's categorisation of individual plants as must-run.

200.2 The EA's assessment of the frequency with which Contact and the merged entity would have been gross pivotal is broadly consistent with Concept's. Both the EA and Concept find that, in the considered period, Contact was gross pivotal approximately 24% of the time (or approximately 4% if must-run assets are not considered). Furthermore, both find that the merged entity would have been gross pivotal approximately 38% of the time (or approximately 10% if must-run assets are not considered).

200.3 However, the EA's preliminary findings in relation to Contact and the merged entity's net pivotality are not consistent with Concept's submissions. Based on the EA's own data, it finds that, in the period considered, Contact was net pivotal in a small number of trading periods (17, or 0.03% of the total) and the merged entity could have been net pivotal up to 7% of the time.¹⁹² As it is currently not clear what is driving the differences between Concept's and the EA's outputs we are continuing to assess the relevant data to understand the cause(s) of this difference in conclusions.

Our current view

201. We agree with Contact's assessment that gross and net pivotality are conceptually useful in considering the extent of market power of generators. Given the homogenous nature of electricity, market power in the wholesale supply of physical electricity appears to be related to level of a generator's output, not to the product quality or innovation. This position also appears to be supported by the EA.¹⁹³
202. Consistent with Contact's views, we consider that gross pivotal suppliers are more likely to withhold flexible assets than must-run assets in a strategy aimed at increasing spot prices. However, we understand from the EA that in an assessment of a supplier's net pivotality, one must take into account its entire generation (including from must-run assets) and compare it to its volume commitments from hedges and retail operations. This is because output from must-run assets is also used to underwrite hedges sold to customers (eg, baseload hedges). As such, we consider that whether assets are must-run or not is irrelevant for the assessment of

¹⁹² The EA finds that, in the period considered, the merged entity would have been net pivotal c. 5% of the time if the merged entity retains all of Manawa's volume commitments and c. 7% if all of Manawa's volume commitments lapse and are not replaced. These two scenarios represent the lower and upper bounds of the likely frequency of the merged entity's net pivotality.

¹⁹³ Electricity Authority – 'Market Monitoring Review of Structure, Conduct and Performance in the Wholesale Electricity Market – summary paper' (27 October 2021) p.4.

a supplier's net pivotality and therefore we only assess the results of the net pivotality analysis based on the inclusion of both flexible and must-run assets.

203. We agree with Contact's submission that a gross pivotal supplier might have an ability to increase electricity spot prices but may not have an incentive to do so. We also agree with Contact that an assessment of a supplier's volume commitments (from the supply of hedges and retail electricity) is necessary to determine whether a supplier is likely to profit from higher electricity spot prices. We therefore assign greater weight to the frequency of the merged entity's net (rather than gross) pivotality.
204. The EA's preliminary re-running of Concept's net pivotality assessment indicates that, as a result of the Proposed Acquisition, the frequency of Contact's net pivotality would increase from c. 0.1% to as much as 7%. This result is inconsistent with Concept's finding that the merged entity would not have been net pivotal at all in the considered period. At this stage, it is not clear what drives the inconsistency in results.
205. Finally, we have considered how the merged entity's net pivotality might change in the next five years. We consider that the frequency of net pivotality of a given supplier is likely to be positively correlated with demand for electricity and negatively correlated with the level of its volume commitments relative to generation and the volume of electricity supplied by its rivals.
- 205.1 Demand for electricity is likely to increase in the next five years. According to MBIE's forecasting, it could grow from approximately 42TWh pa in 2024 to 44-52TWh pa in 2030 (5-23% growth).¹⁹⁴
- 205.2 As the 2,000GWh Mercury Hedge rolls off, the merged entity's position would become longer. If the merged entity recontracts the entire volume to another customer, then, according to the EA's analysis, the merged entity would be net pivotal approximately 5% of the time. If it does not recontract any of this volume, the EA's preliminary findings indicate it would be net pivotal approximately 7% of the time.
- 205.3 According to commercially sensitive information held by Transpower, it is likely that by 2027 the investment by Contact and Manawa's rivals in new plants would yield an additional [] of annual generation ([] of the 2024 generation).¹⁹⁵
206. We consider that the degree of the merged entity's net pivotality in the near future might either remain at its historical levels or could increase, depending on the increase in demand for electricity in the future. If the demand grows materially by 2030 (eg growing by 23% to 52TWh pa, as per MBIE's upper end forecast) it is likely that merged entity's net pivotality will be greater in the future than in the past.

¹⁹⁴ Ministry of Business, Innovation and Employment – 'Electricity Demand and Generation Scenarios: Results summary' (July 2024) at p 1.

¹⁹⁵ Response to request for information from Transpower (2 December 2024).

Conversely if demand grows less strongly (eg to 44TWh pa, or 5% increase from 2024, as per MBIE's lower end forecast), merged entity's net pivotality is unlikely to change materially compared to its historical levels, given that merged entity's rivals are expected to invest in new assets equal to [] of current total annual generation.

207. Also, based on the EA's preliminary findings, it appears that the merged entity's net pivotality would not be immaterial. Even if the merged entity was to fully replace Manawa's Mercury Hedge – thereby shortening its net position and lowering its incentive to increase the spot price – it would still be net pivotal 5% of the time.
208. Based on the above assessment, at this stage we cannot rule out that the merged entity would not have an incentive to engage in strategies resulting in higher spot prices, presently or in the next five years.
209. We invite submissions on any matters of relevance to this analysis including (but not limited to):
- 209.1 whether there are any potential indicators – other than gross or net pivotality – that could be used in the assessment of unilateral effects on the spot price for electricity;
- 209.2 the usefulness of gross and net pivotality for our competition analysis of unilateral effects in the supply of physical electricity;
- 209.3 the extent to which the level of the merged entity's gross and net pivotality – as found by Contact and by the EA – is an appropriate indicator of the merged entity's ability to unilaterally increase the level of electricity spot prices;
- 209.4 the extent to which generators can ascertain – in a timely manner – whether they are gross or net pivotal; and
- 209.5 how the merged entity's net pivotality might change in the next five years.

Temporal output optimisation

210. Whilst we agree with Contact that a pivotal (gross or net) player is likely to have a degree of market power and could affect the level of spot prices, we consider that a generator might also hold a degree of market power and be able to affect spot prices without being gross or net pivotal. This is a consequence of the price determination mechanism in the supply of wholesale electricity, where – if a supplier was to lower its offered output – Transpower would choose the next best available offer, resulting in a higher electricity spot price. Conversely, if a supplier increased its volume offering in a trading period (and its price was below the clearing level), the least competitive offer would be discarded, resulting in a lower electricity spot price.
211. In principle, a supplier could increase its profits by reducing its volume offering when the spot price is very sensitive to the volumes offered by generators (known as 'economic withholding') and expanding it when the spot price is not sensitive. As a result of this action, the spot price might increase materially in the first period and would decline only slightly in the second period. We refer to this strategy as

‘temporal output optimisation’. We understand that this is not necessarily unlawful under the Code.

212. In general, the spot price would be highly sensitive to the volume of electricity offered if, for a given level of demand, the price associated with the marginal offer (that is the last offer selected by the clearing manager to be dispatched) is substantially lower than the next best offer or substantially higher than the infra-marginal offer.
- 212.1 If the former condition is true, then removing one offer from the selected stack of offers might result in the next best offer being selected, materially increasing the spot price in the process.
- 212.2 If the latter condition is true, then adding one offer to the selected stack of offers might result in the previously marginal offer being discarded, materially decreasing the spot price in the process.
213. In practice, the spot price is likely to be more sensitive to volumes offered by generators during peak hours and less sensitive during off peak hours. This is because more offers are needed to be included in the selected stack when demand is high, leaving only the most expensive options out of the stack. Few offers need to be selected to meet the demand during off peak hours, so adding or removing offers during this period is unlikely to result in large changes in the spot price.
214. Whether the ‘temporal output optimisation’ strategy is likely to result in higher average electricity spot prices depends on the degree of temporal fluctuations in spot price sensitivity to the volume of electricity offered by generators. If there are large differences in the price sensitivity over time, a generator with a degree of flexible output generation might find it profitable to engage in temporal output optimisation.
215. Temporal output optimisation can be a profit increasing strategy of utilising one’s asset base. To the extent that the merged entity might be more able or more incentivised to engage in this strategy, this could lead to higher average spot prices than if Contact did not acquire Manawa, thereby potentially harming customers purchasing electricity from the spot market.
216. In the remainder of this section, we set out our assessment of whether the merged entity is likely to engage in a strategy of temporal output optimisation resulting in higher average spot prices.

Views of the Applicant

217. Contact considers that a supplier cannot unilaterally increase or decrease spot prices if it is not pivotal.¹⁹⁶

¹⁹⁶ Letter received from Bell Gully on behalf of Contact Energy (3 December 2024), p. 1.

218. Contact submits that neither Contact now, nor the merged entity after the merger, would be able or have incentive to engage in temporal output optimisation. This is because, according to Contact:¹⁹⁷
- 218.1 Contact always offers supply from all its available plants (unless they are undergoing maintenance) and this would not change after the merger;
 - 218.2 reducing volume offered bears opportunity cost of the revenue lost from not dispatching it;
 - 218.3 it is impossible to predict how the spot price would change if Contact or the merged entity were to change its volume offering;
 - 218.4 spot prices are often insensitive to changes in supply or demand, so Contact or the merged entity would need to reduce their volume offering by a large amount to move prices;
 - 218.5 rivals could increase their volume offering countering a hypothetical strategy of Contact or merged entity reducing their volume offering; and
 - 218.6 unusual offer behaviour might be detected and subject to enforcement action by the EA.

Our current view

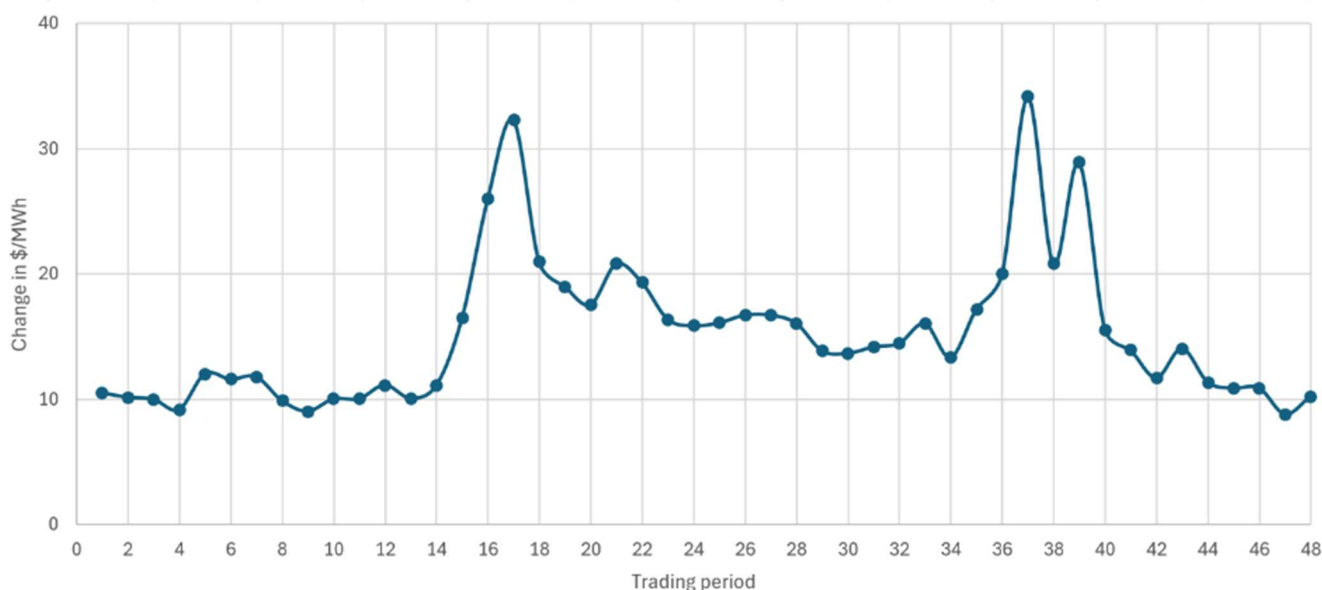
219. In our view, a supplier could affect the level of spot prices without being gross or net pivotal. This is because, if a non-pivotal supplier were to add (or remove) an offer at a below-clearing price, it could decrease (or increase) the level of spot price. We consider that, in principle, the strategy of temporal output optimisation can be profitably implemented – and may lead to higher average spot prices – if a generator has the ability and incentive to do so.
220. With respect to the merged entity's ability to carry out this strategy, we consider that:
- 220.1 ability depends on how well the merged entity can predict the level of price sensitivity; and
 - 220.2 a generator would not need to stop offering volumes from individual plants. In some cases, a generator could reduce or increase the volumes offered from individual plants (or offer the plant's volumes but set a very high price) and still engage in a strategy of temporal output optimisation. This is because some plants, such as thermal or flexible hydro plants, allow generators a degree of flexibility to produce more or less electricity in certain times. Consistently, the ability of a generator to temporally optimise output depends on the degree of asset flexibility.

¹⁹⁷ Letter received from Bell Gully on behalf of Contact Energy (3 December 2024), p. 2.

221. With respect to the merged entity's incentive to carry out this strategy, we consider that:
- 221.1 by reducing the volume offered in a given trading period, a generator would incur an opportunity cost. However, the level of opportunity cost must be assessed against the extra gains from higher spot prices on the remaining volumes dispatched by the generator. As noted by Contact, the larger the fluctuations in the spot price sensitivity to demand and supply, the larger the expected gains from temporal output optimisation relative to opportunity costs;
 - 221.2 a generator might be disincentivised from engaging in temporal output optimisation if there is a real risk of detection and material enforcement action from the EA;
 - 221.3 incentive depends on whether rivals could react to the merged entity reducing its volume offering by increasing theirs, thereby neutralising the effect on the level of spot prices; and
 - 221.4 although not explicitly mentioned by Contact, we consider that a generator's incentive to temporally optimise output depends on the level of its volume commitments (from hedges and retail obligations) relative to its generation. The lower the level of commitments relative to generation, the larger the benefit a generator would yield from higher spot prices.
222. To assess the merged entity's ability to engage in temporal output optimisation after the Proposed Acquisition, we consider whether suppliers can predict the fluctuations in spot price sensitivity to demand and supply and the extent of merged entity's asset flexibility.
- 222.1 First, we have assessed whether the merged entity might reasonably predict the spot price sensitivity to demand and supply. To explore the degree of price sensitivity to the underlying supply and demand, we have relied on publicly available simulations of the EA showing how the spot price in a given trading period would change if demand increased (or decreased) by a small proportion.¹⁹⁸ This is equivalent to price sensitivity with respect to a small decrease (or increase) in supply.
 - 222.1.1 We used this data for the period between 1 October 2023 and 30 September 2024. Each day's data contains information for every trading period within that day. Based on this information, we plotted the average simulated deviation (\$/MWh) in the spot price given a 1% increase in demand (see Figure 1 below) for each trading period.¹⁹⁹

¹⁹⁸ The EA considers price sensitivity with respect to volume changing by -5%, -4%, -3%, -2%, -1.5%, -1%, -0.5%, 0.5%, 1%, 1.5%, 2%, 3%, 4%, and 5%. See: www.emi.ea.govt.nz/r/cjjpgl

¹⁹⁹ This is equivalent to a simulation where 1% of supply is withdrawn.

Figure 1: Change in spot price given hypothetical 1% increase in demand (\$/MWh)

Source: Commission's calculations based on EA's data.

222.1.2 This analysis indicates that the spot price is typically less sensitive to increases of demand at night. This means that the spot price is unlikely to be sensitive to changes in supply in this period.

Conversely, spot prices tend to be more sensitive to demand during the morning peak and even more so during the evening peak. This means that reductions in supply are likely to cause large spot price increases during these peaks. This analysis uses the average change in spot price across an entire year. It is possible that on a given day the simulated deviations may differ from the average trend above.

222.1.3 All suppliers have access to the same data and have the analytical capabilities to run similar simulations. As such, we consider that generators are likely to form reasonable expectations about the evolution of price sensitivity at different trading periods.

222.2 Secondly, both Contact and Manawa have some degree of asset flexibility. As set out in the discussion of ability in the vertical effects section, after the merger, the merged entity would have the second most flexible fleet in New Zealand. Given how sensitive to changes in demand and supply the spot price can be during peak times, we cannot rule out that the merged entity might have the necessary flexibility to shift output from high to low sensitivity periods.

223. It appears that the merged entity would have some ability to engage in temporal output optimisation. Further, by acquiring Manawa, Contact's asset flexibility would become greater, so the merged entity's ability to optimise output temporally would be greater than Contact's pre-merger ability.

224. To assess the merged entity's incentive to engage in temporal output optimisation after the Proposed Acquisition, we consider the magnitude of spot price sensitivity

fluctuations, the risk of enforcement by the EA, the merged entity's exposure to the spot market and potential rivals' responses.

- 224.1 As shown in Figure 1 above, the fluctuations in the sensitivity of spot price to small changes in demand can be material. As expected, spot price sensitivity is materially higher during super-peak trading periods (between 6am to 10am and between 5pm to 11pm) than in other periods. In the assessed period, a 1% increase in demand (or 1% decrease in supply) increases the spot price in super-peak trading periods by \$18/MWh on average, compared to \$13/MWh on average in other periods.
- 224.2 As we discuss in the section below on the ability of the EA to monitor and enforce conduct in the spot market, we consider that the EA is well positioned to detect and enforce against suppliers' attempts to materially increase the spot price. We are continuing to assess whether the current regulatory regime also allows the EA to identify and discipline generators attempting to increase the spot price by small, but not insignificant, amounts.
- 224.3 To assess the merged entity's exposure to the spot prices, we have combined Contact's and Manawa's existing volume commitments²⁰⁰ (including Contact's retail arm) and compared it to their combined electricity generation. Figure 2 below shows the evolution of the merged entity's hypothetical volume commitments in the form of hedges (blue area), retail (dark blue), and the remaining exposure to spot prices between May 2022 and October 2024. Based on this assessment, the merged entity's average hypothetical exposure to spot prices amount to []% of its combined generation. The level of the merged entity's exposure to spot prices depends on the extent to which it would contract out the volumes which will become available as Manawa's Mercury Hedge rolls off. If the merged entity decides not to sell any of these volumes as hedges, its exposure to spot prices would be at []%. Consequently, for every \$1 increase in the average level of the spot price due to temporal output optimisation, the merged entity might gain between \$[] and \$[].

²⁰⁰ For Contact's hedge and volume commitments, we have used its volume commitments available online in its operational reports. For Contact's retail commitments, we have used the retail volume data provided by Contact. For Manawa's hedge commitments, we have used its hedge data provided to us. For Manawa's generation, we have used the figures set out in Frontier Economics' report accompanying Contact's Application.

Figure 2: Merged entity's hypothetical retail commitments, hedge commitments, and exposure to spot prices, May 2022 – October 2024 [

]

Source: Commission's calculations based on Parties' and EA's data.

- 224.4 We have not yet considered the extent to which rival generators might be able to counter the merged entity's temporal output optimisation by increasing their output at times when the merged entity withholds it (and vice versa). We invite submissions on this topic from interested parties.
225. Based on the above assessment, it appears that the merged entity might have an incentive to engage in a temporal output optimisation strategy after the Proposed Acquisition. This is due to large fluctuations in the sensitivity of the spot price to demand and supply []. However, it is currently unclear whether this incentive would be higher or lower than Contact's and Manawa's current incentive to engage in such a strategy and whether the current regulatory regime would allow the EA to respond to such a strategy.
226. While at this stage we cannot rule out any concerns around the Proposed Acquisition increasing the merged entity's ability to temporally optimise its output, for completeness we note that:
- 226.1 we have not yet estimated the level of the profit – if any – that the merged entity might make from temporal output optimisation. However, at this stage we cannot rule out that, post-Acquisition, the merged entity might have an increased ability and incentive to temporally optimise output;
- 226.2 [] consider the supply of wholesale electricity to be highly competitive and did not identify any concerns relating to the merged entity's potential market power in this area.²⁰¹ They consider that there are currently many suppliers on the market (although [] did

²⁰¹ Commerce Commission interview with [] (1 November 2024); Commerce Commission interview with [] (1 November 2024) and Commerce Commission interview with [] (30 October 2024).

note that with the Proposed Acquisition, there would be one less player putting in bids and offers) and that the spot price is thoroughly monitored by the EA, limiting the likelihood of any unilateral attempts to increase the level of the spot price;²⁰² and

- 226.3 none of the independent retailers we have contacted raised any concerns about the impact of the Proposed Acquisition on the level of electricity spot prices.
227. We invite submissions on:
- 227.1 whether temporal output optimisation is a strategy that is used by any of the generators;
- 227.2 whether a temporal output optimisation strategy would be more financially profitable for the merged entity than it currently is for Contact;
- 227.3 how to approach a modelling exercise to determine whether the merged entity might be incentivised to temporally optimise output;
- 227.4 the extent to which temporal output optimisation might affect the average level of spot prices; and
- 227.5 the extent to which the Proposed Acquisition would increase instances of temporal output optimisation by the merged entity or other generators.

Ability of the EA to monitor and enforce conduct in the spot market

228. The EA is responsible for ensuring the industry operates efficiently, reliably and competitively.²⁰³ The EA is also responsible for monitoring the electricity market and enforcing the relevant rules.²⁰⁴ As such, we have considered whether the EA is likely to be able to utilise its monitoring and enforcement tools to sufficiently constrain any attempted exercise of market power by the merged entity post-Acquisition.

Views of the Applicant

229. Contact submits that the Code, which is governed by the EA, provides an additional market protection against the ability of market participants to exercise market power in the wholesale electricity market.²⁰⁵ In particular, Contact submits that the High Standard of Trading Conduct (HSOTC) provision (Clause 13.5A of the Code) provides that an offer submitted or revised by a generator must be consistent with the offer that the generator, acting rationally, would have made if no generator

²⁰² Commerce Commission interview with [] (1 November 2024); Commerce Commission interview with [] (1 November 2024) and Commerce Commission interview with [] (30 October 2024).

²⁰³ <https://www.ea.govt.nz/industry/wholesale/>.

²⁰⁴ <https://www.ea.govt.nz/code-and-compliance/investigations-and-rulings/>.

²⁰⁵ The Application at [26.24].

could exercise significant market power at the relevant time.²⁰⁶ Contact submits that this provision is monitored closely by the EA.

230. Contact also submits that third parties' ability to report instances of any undesirable trading situations (UTS) (such as trading conduct which is misleading or deceptive) which may be a breach of the Code also provides an additional regulatory check on any possible exercise of market power by the merged entity.²⁰⁷ Contact submits that the EA investigates all UTS that are reported and may then take action to correct the situation.

Our current view

231. Based on evidence from the EA and market participants, our current view is that the EA is effective at monitoring and detecting situations where there is an unexplained large spike in prices that might be caused by a generator exercising market power.

231.1 Through its surveillance of the market the EA is able to monitor for and identify trading periods of interest, where the EA may suspect that the offer put forward by a generator does not reflect the underlying supply and demand conditions.²⁰⁸ The EA is then able to look at the offer submissions and revisions to understand whether there is anything that could explain the higher offer (such as a generator experiencing operational issues). The EA can also monitor how changes in offers leading up to the trading period of interest.

231.2 Suspected incidences of non-compliance with the HSOTC rule can be flagged by the EA for further analysis.²⁰⁹ Cases that warrant further scrutiny can be passed on to the EA's Compliance Committee, after which an investigator may be appointed that provides a report and recommendation to the Committee. The Committee then decides what action to take, which can involve settlement, discontinuation of the investigation or the recommendation to lay a formal complaint with the Rulings Panel.²¹⁰ The Rulings Panel is an independent body that can impose penalties, award costs or compensation and recommend amendments to the Code.²¹¹

231.3 The EA also provides weekly trading conduct reports, carries out quarterly reviews of the wholesale market and conducts in-depth reviews and studies of particular topics.²¹²

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²⁰⁶ The Application at [26.25].

²⁰⁷ The Application at [26.26].

²⁰⁸ <https://www.ea.govt.nz/industry/monitoring/>.

²⁰⁹ <https://www.ea.govt.nz/industry/monitoring/>.

²¹⁰ <https://www.ea.govt.nz/code-and-compliance/report-a-breach/>.

²¹¹ <https://www.ea.govt.nz/code-and-compliance/report-a-breach/>.

²¹² <https://www.ea.govt.nz/industry/monitoring/monitoring-the-market/>.

].²¹³ The EA is currently undertaking a review of the high prices that occurred in winter 2024.

- 231.4 Gentailers in particular view the EA as an effective regulator, agreeing that the EA monitors the market closely. One gentailer told us that there are lots of checks and balances on behaviour in the “highly competitive” spot market.²¹⁴ Another gentailer agreed that the trading conduct rules under the Code are “pretty well policed and enforced” and that the EA would notice if a generator was to use their transient market power.²¹⁵ A third gentailer told us that the EA is quick to act, and that it has the power to reset prices and stop any gain to be extracted by generators. This gentailer also noted that it can raise issues with the EA and has done so in the past.²¹⁶
- 231.5 While a few of the independent retailers raised concerns about the EA’s regulation of the industry, the majority of their concerns appear to relate to the structure of the industry rather than the EA’s monitoring of the spot market. For example, two retailers told us they had raised a lack of access to Shaped Hedges with the EA²¹⁷ and Electric Kiwi submitted that the different projects and workstreams the EA has underway do not sufficiently address the systemic issues present.²¹⁸ However, another retailer told us that the EA cannot be relied upon as a constraint as, although the trading conduct rules exist, the EA has not applied them.²¹⁹
232. It is less clear to us whether the regulatory regime under which the EA operates enables the EA to monitor and detect situations where there are smaller spikes in prices. The Code sets out that if the EA suspects or anticipates the development or possible development of any UTS, defined in the Code as “any situation that threatens, or may threaten, confidence in, or the integrity of, the wholesale market”, it may investigate the matter.²²⁰ While a large increase in spot prices would qualify as a UTS and be able to be investigated by the EA, we are not yet certain that a smaller increase in price would qualify as one.
233. We intend to test further with industry participants to determine whether the EA would be able to detect the extent to which the merged entity – by exercising its potential net pivotality position or by temporally optimising output – is able to increase its prices, thereby increasing the spot price. If the regulatory regime under which the EA operates enables the EA to detect this kind of conduct, we may be able

²¹³ Commerce Commission meeting with the Electricity Authority ([redacted]).

²¹⁴ Commerce Commission interview with [redacted] (1 November 2024).

²¹⁵ Commerce Commission interview with [redacted] (1 November 2024).

²¹⁶ Commerce Commission interview with [redacted] (30 October 2024).

²¹⁷ Commerce Commission interview with [redacted] (31 October 2024) and Commerce Commission interview with [redacted] (31 October 2024).

²¹⁸ Electric Kiwi: ‘Submission on Contact/Manawa Clearance Application’ (7 November 2024) at [71].

²¹⁹ Commerce Commission interview with [redacted] (31 October 2024).

²²⁰ See the Code at Part 1 at [1.1(1)] and Part 5 at [5.1].

to rely on its presence as an effective constraint against more subtle price increases by the merged entity post-Acquisition.

234. We invite submissions on the extent to which the regulatory regime enables the EA to monitor and enforce smaller increases in the spot price, including disciplining instances of temporal output optimisation.

Coordinated effects – wholesale supply of physical electricity

235. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to act in a coordinated way.²²¹
236. Post-acquisition, Manawa would no longer be an independent generator of electricity.
237. When assessing whether an acquisition may give rise to coordinated effects in a given market, we assess whether:²²²
- 237.1 the relevant market is vulnerable to coordination; and
- 237.2 the acquisition would change conditions in the relevant market so that coordination is more likely, more complete or more sustainable.
238. At this stage, we are not satisfied that the Proposed Acquisition would not be likely to increase the potential for coordination in the wholesale supply of physical electricity.

Views of the Applicant

239. Contact submits that the Proposed Acquisition would not increase the potential for coordinated conduct in any relevant markets in New Zealand because:²²³
- 239.1 Manawa is a small generator with only a 4.3% share of total electricity generation in New Zealand and this small increment in Contact's generation share will not alter market dynamics;
- 239.2 a large portion of the merged entity's assets are "must-run" (ie, plants which cannot easily be switched on and off) meaning they cannot be used to engage in coordinated behaviour as their output is determined by the weather rather than market conditions;
- 239.3 while a number of suppliers might be gross pivotal (meaning their supply is needed to fulfil wholesale demand), it is not the case that all of them will

²²¹ Mergers and Acquisitions Guidelines above n5 at [3.84].

²²² Mergers and Acquisitions Guidelines above n5 at [3.86].

²²³ The Application at [31.1].

have the incentive to raise prices (ie, it is not the case that all of them are net pivotal). Further, because not all suppliers will share a common incentive to raise spot prices during a particular sales period, tacit coordination of any short-term output would not be feasible;

- 239.4 trading conduct rules, which the EA closely monitors, serve as safeguard against coordinated market power. The EA monitors any spillage of generation, and any third party would be able to report detected spillage; and
- 239.5 if there was a sustained attempt by suppliers to collectively raise prices or limit output, it would promote a competitive response that would signal the need to further accelerate investment in new generation capacity in the wholesale market.

Our current view

240. We consider the following features of the market for the wholesale supply of physical electricity mean it may currently be vulnerable to coordination.
- 240.1 **Market concentration:** there is a small number of key generators, with the four largest suppliers (Meridian, Contact, Mercury, Genesis) accounting for 85% of the overall generation. It is easier for a few firms to coordinate their behaviour which implies any potential coordination would likely be sustainable. A market with fewer firms is more vulnerable to coordination because the relative gain from deviating from a coordinated outcome is smaller than it would be with a larger number of firms.
- 240.2 **Concentration in the supply of flexible generation:** the four gentailers own 95% of output from flexible generation (thermal and flexible hydro). As a consequence, coordination would be easier to reach at times when intermittent energy is scarce, and spot prices are at elevated levels.
- 240.3 **Firm structure:** 85% of overall electricity and 95% of flexible generation is currently produced by vertically integrated firms. A market where firms have similar structures might make collusion more sustainable as vertically integrated firms might face similar risks (eg all gentailers have reduced exposure to the spot market due to owning a retail arm) and have similar business strategies.
- 240.4 **Price transparency:** prices and volumes offered by generators are publicly available, which makes it easier to monitor, detect and punish any deviations from a tacit agreement.
- 240.5 **Frequency of interaction:** the large number of trades per day means gentailers have numerous, repeated interactions with one another and are able to observe – and discipline – others' behaviour.
- 240.6 **Lack of demand lumpiness:** wholesale electricity is sold every 30 minutes and, as such, is not 'lumpy'. Therefore, any participants involved in

coordination are unlikely to benefit materially from deviating from the agreement.

241. However, we also consider that the following features may make the market less vulnerable to coordination.

241.1 **Difficulty deciding on a coordination mechanism:** in a potential coordination of the supply of wholesale electricity, generators would need to agree on the volumes and prices they offer for particular trading periods and injection points. There are 52 injection points and 48 trading periods in a day. Generators' volume and price offers can be granular – they can offer up to five volume and price brackets per plant.²²⁴ Any coordination – with or without the Proposed Acquisition – would require a shared understanding on the level of volumes and prices offered to the grid for a particular time period and location. This is likely to be difficult in practice.

241.2 **Different cost structures of suppliers:** the four gentailers appear to have different cost structures due to differences in their asset portfolios. Because they own some thermal plants, Genesis' and Contact's cost base depends to some extent on gas prices. Meridian's portfolio is fully based on hydro plants, so its cost base is independent of commodity prices. As such, gentailers' incentives to maintain agreement may differ, making coordination less sustainable and probable.

241.3 **New entrants:** new entrants are expected to enter the market, potentially decreasing the likelihood of coordination. However, most of the new entrants will supply intermittent energy, so they will not be able to disrupt a potential coordinated agreement at time when intermittent energy is scarce.

241.4 **Enforcement action:** the EA is likely well-positioned to detect if a supplier was to offer materially higher prices than normally. However, as identified earlier, we are considering whether the regulatory regime of the EA enables it to identify smaller, but significant, increases in prices.

242. Whilst the exact coordination mechanism appears difficult to achieve, on balance, it appears that the market for wholesale supply of physical electricity contains several features that makes it vulnerable to coordination.

243. We also consider that the removal of Manawa as an independent may change conditions in the market such that coordination is more likely, more complete or more sustainable. This is because:

243.1 Currently, Manawa injects electricity to the grid in seven regions where Contact does not.²²⁵ Additionally, Contact currently injects electricity to the

²²⁴ For example, a generator could offer three brackets: 0.1MWh of electricity from its plant for \$0.01/MWh, another 0.2MWh for \$1, and another 0.2MWh for \$5.

²²⁵ Waikato/Bay of Plenty, Manawatu/Wanganui, Ruapehu, Marlborough, Nelson, West Coast, and Northland. See the Application at [20.5].

grid in one region where Manawa does not.²²⁶ After the Proposed Acquisition, the merged entity would be affecting electricity volumes and prices at a great number of injection points in more regions than Contact is currently. Wider geographic spread of generation – and greater degree of control over the volumes and prices at specific nodes – would likely simplify any attempts to coordinate the total volume generated by coordination participants and the electricity spot price.

243.2 Manawa would increase Contact’s degree of generation flexibility. As set out in the vertical effects section on the ability of the merged entity to foreclose rival electricity retailers and generators, the merged entity would likely become the second most flexible generator in New Zealand. Greater control over the volume of electricity generated is likely to increase the merged entity’s ability to comply with the terms of any coordination.

243.3 Manawa, through being an independent generator and having different incentives to generators, may currently be able to act as a destabilising competitor in the market for the wholesale supply of physical electricity. Before the Proposed Acquisition, Manawa’s volumes and prices of generated electricity would not be influenced by its retail operations, given that it is currently not vertically integrated. After the Proposed Acquisition, Manawa’s output would be – to some extent – influenced by Contact’s retail operations. Other key generators – Meridian, Mercury and Genesis – are also vertically integrated. The Proposed Acquisition will therefore increase the level of symmetry between generators (in terms of vertical integration) and may result in more sustainable coordination because a greater proportion of generation would be produced by gentailers – as opposed to independent generators – than it is currently.

244. On balance, at this stage we cannot rule out that the Proposed Acquisition will not make coordination more likely, complete or sustainable in the market for the wholesale supply of physical electricity.
245. We invite submissions on the extent to which the Proposed Acquisition would be likely to make coordination in the market for the wholesale supply of physical electricity more likely, complete or sustainable.

Next steps

246. The Commission is currently scheduled to make a decision on the Application by **31 March 2025**. However, this date may be extended with agreement of the Applicant if the material before the Commission at that time does not allow it to be satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.²²⁷

²²⁶ Auckland. See the Application at [20.5].

²²⁷ The Commission maintains a clearance register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

247. As part of our investigation, we are identifying and contacting parties that we consider will be able to help us assess the issues identified above.

Making a submission

248. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Acquisition. We welcome any further evidence and other relevant information and documents that the parties or any other interested parties are able to provide regarding the issues identified in this Sol.
249. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference 'Contact/Manawa' in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **21 February 2025**.
250. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.
251. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
252. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would be likely to unreasonably prejudice the commercial position of the supplier or subject of the information.