

Statement of Preliminary Issues

Mercury NZ Limited / Trustpower Limited's retail business

17 August 2021

Introduction

1. On 3 August 2021, we registered an application from Mercury NZ Limited (Mercury) seeking clearance to acquire Trustpower Limited's (Trustpower) retail business (the Proposed Acquisition).¹
2. The Commission will give clearance if it is 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.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.²
4. As set out in the Framework section below, our assessment of the Proposed Acquisition is limited to the impact of the transaction on competition in New Zealand markets. Except to the extent it is relevant to the Proposed Acquisition, our clearance process does not involve assessment of the competitive workability of the relevant markets in general.
5. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by close of business on **31 August 2021**.

The parties and the Proposed Acquisition

6. Mercury and Trustpower both generate electricity and sell electricity to a range of customers and are two of the five traditional 'gentailers' that operate in New Zealand.³ In addition to electricity, Mercury and Trustpower also supply, to varying degrees, other utility services such as gas and broadband.
7. Mercury is seeking clearance to acquire Trustpower's retail business. This business comprises the retailing of electricity, gas, internet and telecommunications services

¹ A public version of the application is available on our website at:
<http://www.comcom.govt.nz/businesscompetition/mergers-and-acquisitions/clearances/clearances-register/>

² The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

³ The others being Contact Energy Limited, Genesis Energy Limited and Meridian Energy Limited.

to residential and small and medium enterprise (SME) customers, 'Trustpower' branding and the necessary IT systems and employees to service these customers. Currently, Trustpower's retail business consists of approximately 234,000 customer contracts covering approximately:⁴

- 7.1 249,000 electricity connections (known as installation control points or ICPs);
 - 7.2 43,000 gas connections (35,500 of which are connected to the North Island reticulated gas network, with the remainder being bottled LPG users); and
 - 7.3 109,000 telco customers (to which broadband, fixed wireless, voice and mobile retail services are provided).
8. The Proposed Acquisition does not include any of Trustpower's:
- 8.1 generation assets; or
 - 8.2 existing commercial and industrial electricity customers.⁵

Our framework

9. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.⁶ As required by the Commerce Act 1986 (the Act), we assess mergers and acquisitions using the substantial lessening of competition test.
10. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).⁷ This allows us to assess the degree by which the Proposed Acquisition might lessen competition in a market.
11. If the lessening of competition resulting from the Proposed Acquisition is likely to be substantial in a market, we will not give clearance. When making that assessment, we consider, among other matters:
- 11.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;⁸

⁴ Clearance application from Mercury at [9].

⁵ Clearance application from Mercury at [11].

⁶ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz.

⁷ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁸ References to price increases in this document should be taken to include a reduction in quality, service or innovation.

- 11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
- 11.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

Market definition

- 12. 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. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.⁹
- 13. Relevant to the Proposed Acquisition, Mercury and Trustpower primarily overlap in the supply of electricity and gas to residential and SME customers and we will assess the most relevant market(s) for the supply of these two products. However, we will also test whether there are any other relevant markets for the supply of other utility products and/or services.¹⁰

Overlap in the supply of electricity

- 14. In its application, Mercury submitted there is a national market for the retail supply of electricity to residential and SME customers (together, mass market customers). Mercury considers this is primarily because:¹¹
 - 14.1 the vast majority of electricity consumed by residential and SME customers comes from electricity generated and supplied to the national grid by the country’s main generators such as Contact Energy Limited, Genesis Energy Limited, Meridian Energy Limited, Trustpower and Mercury;
 - 14.2 all electricity retailers can serve all residential and SME customers across the entire country. Retailers can do this by entering into distribution agreements with all the electricity distribution businesses, as well as the relevant metering providers; and
 - 14.3 there is no material difference between the requirements of, and competitive alternatives available to, residential customers compared to SME customers.
- 15. We will consider the relevant functional, geographic and customer market(s) for the supply of electricity.

⁹ Section 3(1A); See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

¹⁰ For example, Mercury notes that Mercury and Trustpower both overlap in the retail supply of broadband services but the Commission does not need to assess this market because the overlap is relatively small and there are a number of large existing suppliers. Clearance application from Mercury at [336]-[341].

¹¹ Clearance application from Mercury at [145]-[146].

16. Mercury considers that, because it is acquiring Trustpower's retail electricity customers, the only relevant functional level for the purposes of assessing the Proposed Acquisition is the retail level.
17. In addition to the retail supply of electricity, we will also consider whether any relevant wholesale electricity market(s) may be relevant to our assessment.
- 17.1 Mercury and Trustpower currently compete with one another, and with other gentailers, to wholesale electricity and would continue to do so in the factual scenario since Trustpower's generation assets are excluded from the Proposed Acquisition.
- 17.2 We understand that all retailers acquire electricity from the wholesale electricity spot market. As pricing on the wholesale spot market varies, retailers generally seek to manage their exposure to changes in the spot price. Sometimes this is achieved by entering into supplementary contracts and/or financial hedging arrangements. For example, as part of the Proposed Acquisition, Mercury intends to enter into a ten year wholesale electricity hedge arrangement with Trustpower.¹² We will test whether all methods used by retailers to acquire wholesale electricity compete in the same market and whether the proposed hedge arrangement has effects on wholesale market competition.
18. We will consider whether the relevant market for the retail supply of electricity is national or whether more narrowly regional and/or local markets should be defined. As part of this, we will assess:
- 18.1 the extent to which electricity retailers compete with one another in different regions of New Zealand; and
- 18.2 whether retailers' abilities to enter and/or expand in different regions is impacted by customer switching behaviour, transmission constraints and/or other factors.¹³
19. We will test whether there is a single market for the retail supply of electricity to residential customers and to SME customers, or whether it is appropriate to define separate markets for certain groups of customers.¹⁴

¹² Clearance application from Mercury at [12].

¹³ Mercury submits that even if the Commission defines separate regional, local or town geographic retail markets, the competition analysis would not change because the same competitive constraints would exist regardless of location. Clearance application from Mercury at [147].

¹⁴ At this stage, we are not intending to assess the requirements of any commercial and/or industrial electricity customers. While Mercury and Trustpower currently supply commercial and industrial customers, Trustpower's existing commercial and industrial electricity customers do not form part of the Proposed Acquisition. Clearance application from Mercury at [11.1].

Overlap in the supply of gas

20. In its application, Mercury submitted there is a North Island market for the retail supply of reticulated gas to residential and SME customers primarily because:¹⁵
- 20.1 all North Island reticulated gas customers are supplied with natural gas that is transported to them initially on First Gas Limited's high pressure transmission network and then on local distribution pipeline networks;
 - 20.2 all reticulated gas retailers are able to supply customers on the reticulated network by entering into distribution agreements with First Gas Limited, with each respective local distribution pipeline network owner and with the relevant gas metering companies; and
 - 20.3 there is no material difference between supplying residential and SME gas customers and Mercury does not compete for large commercial or industrial customers.
21. We will consider the relevant geographic and customer market(s) for the retail supply of reticulated gas to residential and SME customers.¹⁶
22. We will consider whether there is a single relevant market that covers the North Island's reticulated gas network or whether there are more narrowly defined markets based on local distribution pipeline networks. This will involve testing whether there are any significant barriers to gas retailers operating across the North Island's reticulated gas network.
23. As with electricity customers, we will test whether the retail supply of reticulated gas to residential customers and to SME customers comprises a single relevant market, or whether it is appropriate to define separate markets for certain groups of customers.

Without the acquisition

24. Mercury considers the Proposed Acquisition is best assessed against a status quo counterfactual, with that counterfactual reflecting Trustpower retaining its retail business.¹⁷
25. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo or whether the counterfactual may be something other than the status quo.

¹⁵ Clearance application from Mercury at [275]-[276].

¹⁶ For example, we are not intending to assess the supply of bottled LPG gas to any customers because there is no overlap between the merging parties. In addition, Mercury does not currently supply reticulated gas to any commercial or industrial customer. Clearance application from Mercury at [233].

¹⁷ Clearance application from Mercury at [25].

Preliminary issues

26. We will consider whether the Proposed Acquisition would be likely to substantially lessen competition in any relevant market(s) by assessing whether horizontal unilateral effects, coordination and/or conglomerate effects might result from the Proposed Acquisition.
27. Given the apparent similarities between the electricity and gas industries, the preliminary issues outlined below describe a common approach to how we intend to analyse competition in the relevant electricity and gas markets.

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

28. 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 profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses. A merger could also reduce competition if one of the merging firms was a potential or emerging competitor.
29. Mercury submitted that existing competitors would provide sufficient constraint on the merged entity such that the Proposed Acquisition would not have, or be likely to have, the effect of substantially lessening competition in:
 - 29.1 any market for the retail supply of electricity to mass market customers;¹⁸ or
 - 29.2 any market for the retail supply of reticulated gas to mass market customers.¹⁹
30. Mercury considers the Proposed Acquisition would only result in a marginal increase in Mercury's scale and it would not give Mercury any greater influence or power over its electricity and gas competitors such that it could increase electricity or gas retail prices.²⁰ Mercury considers this is primarily because:
 - 30.1 Mercury and Trustpower are not each other's closest competitors in any region for any electricity or gas retail product or service;²¹
 - 30.2 existing electricity and gas retailers would individually and collectively act as a significant constraint on the merged entity primarily because there are no constraints on the existing large retailers increasing the number of customers they supply;²² and

¹⁸ Clearance application from Mercury at [176].

¹⁹ Clearance application from Mercury at [301].

²⁰ Clearance application from Mercury at [180] and [302].

²¹ Clearance application from Mercury at [163.2] and [315].

²² Clearance application from Mercury at [198] and [311].

- 30.3 there are limited barriers to electricity and gas mass market customers switching retailers.²³
31. We will consider:
- 31.1 the degree of competitive constraint that Mercury and Trustpower would impose upon one another in the counterfactual. If this constraint is material, we will assess whether the competition lost between the merging parties could be replaced by rival competitors; and
- 31.2 how easily rivals could enter and/or expand in response to a price increase by the merged entity in any relevant market, and whether any entry and/or expansion is likely to occur in a timely manner.

Coordinated effects: does the Proposed Acquisition make coordination more likely?

32. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining rivals to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market. 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 be acting in a coordinated way.
33. Mercury submitted that the Proposed Acquisition will not, and will not be likely to, increase the potential for coordinated effects to arise in any relevant retail electricity or gas market primarily because:
- 33.1 there are a range of existing retail electricity and gas competitors and so, with the Proposed Acquisition, there would be no retail markets that would be controlled by a small number of competitors;²⁴
- 33.2 electricity and gas industry participants do not frequently or repeatedly interact with one another;²⁵ and
- 33.3 electricity and gas industry participants can not readily observe each other's pricing and capacity.²⁶
34. We will assess whether the Proposed Acquisition would make coordination more likely, more complete or more sustainable. As part of our assessment we will consider whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant markets. In particular, this will involve testing:

²³ Clearance application from Mercury at [187] and [309].

²⁴ Clearance application from Mercury at [209] and [326].

²⁵ Clearance application from Mercury at [209] and [326].

²⁶ Clearance application from Mercury at [209] and [326].

- 34.1 the impact of the removal of Trustpower as a competitor in the relevant electricity or gas market(s);
- 34.2 the ability and incentive of the merged entity and other gentailers to exclude or marginalise independent retailers;
- 34.3 the ability and incentive of the merged entity and some or all of the remaining retailers to profitability increase prices to any retail electricity or gas customers; and
- 34.4 the ability and incentive of the merged entity and some or all of the remaining competitors to allocate any electricity or gas customers among themselves.

Conglomerate effects: would the merged entity be able to foreclose rivals?

- 35. 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 or conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively (which we refer to as ‘foreclosing rivals’).
- 36. Mercury submitted that the Proposed Acquisition would not have, or be likely to have, the effect of substantial lessening competition due to conglomerate effects because Mercury’s acquisition of Trustpower’s retail businesses will not give it any new or greater bundling capabilities than what already exist in the wider utilities industry.
 - 36.1 Mercury currently offers retail bundles of electricity and gas and the Proposed Acquisition would allow Mercury to offer a utilities product bundle with broadband and other telecommunication products.²⁷
 - 36.2 While a ‘four product’ bundled offering would be new to Mercury, it is not a new dynamic to the industry (as Trustpower already offers such a bundle) and so the Proposed Acquisition would not give the merged entity any special or particular competitive advantage that would allow it to foreclose competition from rivals.²⁸
- 37. We will assess whether the Proposed Acquisition would be likely to give the merged entity the ability and incentive to foreclose rivals. In particular, we will consider whether:
 - 37.1 the merged entity would gain the ability to offer any new bundle that could not currently be offered by either Mercury or Trustpower, or by other rivals;

²⁷ While Mercury supplies broadband services via its shareholding in Now New Zealand Limited, it does not currently retail broadband as a bundle when it is retailing electricity and gas. Clearance application from Mercury at [330] and [336].

²⁸ Clearance application from Mercury at [215] and [332].

- 37.2 the merged entity would have the incentive to tie products together or offer bundled discounts; and
- 37.3 such behaviour would substantially lessen competition, including the extent to which other competitors could offer similar bundles.

Next steps in our investigation

- 38. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **28 September 2021**. However, this date may change as our investigation progresses.²⁹ In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
- 39. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

- 40. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference 'Mercury/Trustpower' 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 **31 August 2021**.
- 41. 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.
- 42. 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 unreasonably prejudice the supplier or subject of the information.

²⁹ The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.