

Statement of Preliminary Issues

Vector / Arc

25 September 2014

Introduction

1. On 5 September 2014, the Commerce Commission received an application from Vector Limited (Vector) seeking clearance to acquire Arc Innovations Limited (Arc) from Meridian Energy Limited (Meridian).
2. The public version of the application is available on our website at:
<http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/839>
3. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.
4. We invite interested parties to make comment on the likely competitive effects of the proposed acquisition and request that parties who wish to make a submission do so by **Friday 3 October 2014**.

The parties and the transaction

5. Vector is predominantly an electricity lines, gas distribution and energy retailing company and is listed on the New Zealand stock exchange. In addition to its core businesses, Vector is also a provider of communication and IT services, and through its subsidiaries, Advanced Metering Assets Limited and Advanced Metering Services Limited, provides electricity metering services to various electricity retailers.
6. Electricity metering services relate to two types of electricity meters: meters with remote connectivity (advanced or smart meters); and meters without (legacy meters). Legacy meters are in the process of being phased out so Vector primarily provides advanced electricity metering services. This involves supplying advanced meters together with the necessary communication and information storage systems which enable electricity usage to be monitored and recorded remotely.
7. Like Vector, Arc also provides advanced electricity metering services to various electricity retailers. Arc is a wholly owned subsidiary of Meridian, a publicly listed electricity generator and retailer.
8. With the acquisition, Vector would acquire all of the shares in Arc from Meridian.

Our framework

9. As required by the Commerce Act 1986, we assess whether a merger is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.¹
10. We ask whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
11. A tool used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.³ A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of “fact and commercial common sense”.⁴
12. We define markets in the way that we consider best isolates the key competitive constraints on the merging parties. In many cases this may not require us to precisely define the boundaries of a market.
13. We analyse the extent of competition in each relevant market both with and without the merger to determine whether the merger would be likely to substantially lessen competition.
14. We assess the following three factors when considering whether this is likely to be the case.
 - 14.1 Existing competition – the degree to which existing competitors compete.
 - 14.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.
 - 14.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by a purchaser’s ability to exert substantial influence on negotiations.
15. A comparison of the extent of competition both with and without the merger enables us to assess the degree by which the proposed merger might lessen

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013.

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³ *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

⁴ Similarly, the courts have said that “[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices”. See *Commerce Commission v New Zealand Bus Limited* (HC), above n 3 at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

competition. If the lessening is likely to be substantial, we may not give clearance to the proposed merger.

Preliminary issues

16. The Commission will assess the following matters that might arise as a result of this acquisition.

Market Definition

17. Both Vector and Arc provide advanced metering services to electricity retailers in New Zealand.
18. Vector considers that the relevant markets are the national markets for:
 - 18.1 the provision of installed advanced electricity meters and associated telecommunications infrastructure; and
 - 18.2 the provision of data collection/retrieval services using advanced electricity meters and the provision of event/transactional services using those meters.
19. We will consider whether the ownership and installation of advanced electricity meters (including the telecommunications infrastructure that the meters connect to) are, as Vector contends, separate from the provision of metering services, which relate to the information that is extracted from an advanced meter.
20. In addition, we will consider whether the various components that make up metering services are in discrete product markets themselves. Vector considers the provision of metering services involves the following components:
 - 20.1 data collection/retrieval services, which involves recording and aggregating the electricity usage of each meter;
 - 20.2 event/transactional services, which involves being able to perform particular meter functions via remote control; and
 - 20.3 the necessary repair and maintenance services required for each meter.
21. We will consider whether the relevant markets should be national or regional.
22. Vector considers the relevant markets are national because the major customers are electricity retailers who contract for metering services and installation on a national basis, which means that metering suppliers need to be able to supply nationwide. However, Vector also notes that some retailers contract for specific geographic areas, which could suggest regional markets.
23. We will also consider whether there are separate markets for industrial and commercial electricity users, who use different meters to residential users.

Existing competition

24. We will consider the closeness of competition between Vector and Arc and between the merging parties and other suppliers.
25. Vector does not consider that it competes closely with Arc. Rather, Vector considers that Metrix Limited is its main competitor. Vector notes that Arc primarily provides meters and metering services to its parent company, Meridian, and that the remaining electricity retailers have entered into, or are intending to enter into, long term supply contracts with either Vector or Metrix Limited.
26. For those electricity retailers who currently have a contract in place with a metering supplier, we will consider what options they will have when their contracts expire.
27. We understand that some electricity retailers do not currently have a long-term contract in place with an advanced metering supplier. We will assess the competitive alternatives available to those retailers both with and without the proposed acquisition.
28. We will also consider how metering providers compete to install meters in new buildings and whether any such competition would be impacted by the proposed acquisition.

Potential competition

29. For each of the relevant markets, we will consider the entry and expansion conditions and whether entry or expansion is likely, timely and sufficient in extent to prevent a substantial lessening of competition. In particular, this will include considering whether there would be a sufficient number of electricity retailers who are not already contracted to a particular supplier and who would be considered potential customers for any new entrant.
30. Vector considers that new entry is most likely to occur when the existing contracts between electricity retailers and metering suppliers expire. For example, if incentivised by a large contract from an electricity retailer, Vector considers a number of parties would be likely entrants including:
 - 30.1 metering equipment manufacturers;
 - 30.2 a range of technology or infrastructure providers; and
 - 30.3 existing metering providers in other countries.
31. We will assess whether entry is likely to occur when existing contracts expire, given the likely state of competition at that time and the expected profitability of any such entry.

Other competition issues

32. We will consider whether the major electricity retailers would have any countervailing power, should the merged entity attempt to exercise any potential

market power. While we understand that some retailers have long-term contracts in place, we will consider whether these contracts would prevent the merged entity from materially altering the conditions of supply to these customers. We will also consider whether some retailers, when their existing contract expires, would either have sufficient volume to sponsor new entry or the ability to self supply their own requirements.

33. We will also consider whether the removal of Arc as a competitor might raise the prospect of coordinated effects by allowing the remaining firms to coordinate their behaviour, which could result in increased prices or a reduction in the quality of service (or innovation).

Next steps

34. We are currently aiming to make our decision by **Friday 28 November 2014**. However, this date may change as the investigation progresses.
35. To keep up to date with any changes to our deadline and to find relevant documents, visit our clearance register on our website at <http://www.comcom.govt.nz/clearances-register/>
36. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above.
37. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Vector/Arc in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business on **Friday 3 October 2014**. Please clearly identify any confidential information contained in the submission and provide contact details.