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COMMERCE COMMISSION

Decision No. 476

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

GENESIS POWER LIMITED

and

ENERGY ONLINE LIMITED

The Commission:	MJ Belgrave PR Rebstock PJM Taylor
Summary of Application:	The acquisition by Genesis Power Limited, through its subsidiary GP No.3 Limited, of Energy Online Limited's business of retailing electricity to customers at locations in the North Island, and assets incidental to that business.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	10 October 2002

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THE PROPOSAL

1. A notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") was registered on 5 September 2002. The notice sought clearance for the acquisition by Genesis Power Limited ("Genesis" or "the Applicant"), through its subsidiary GP No.3 Limited, of Energy Online Limited's ("EOL") business of retailing electricity to customers at locations in the North Island, and assets incidental to that business.

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Two extensions of time were sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the application was required by 11 October 2002.

3. The Commission's determination is based on an investigation conducted by staff.

4. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

PARTIES

Genesis

5. Genesis is a State Owned Enterprise that generates, wholesales and retails electricity. In addition, Genesis retails gas through its recent acquisition of the gas retail customer base of Natural Gas Corporation Holdings Limited. Genesis owns seven power stations throughout the North Island. As at December 2001, Genesis had [ ] electricity customers, the majority of which are in the North Island.

EOL

6. EOL was registered in May 1999, following the introduction of the Electricity Industry Reform Act 1998 ("EIRA"). EOL is a subsidiary of the Newcall Group, a publicly listed company on the New Zealand Stock Exchange, and retails electricity to approximately 19,000 customers in Whangaparoa, North Shore, Wellsford, Walkworth, Auckland, Thames Valley, Cambridge, Waipa, Taupo, Rotorua, Te Awamutu, Tauranga and Hawkes Bay. The customers are primarily small to medium size businesses and residential customers.

OTHER INDUSTRY PARTICIPANTS

7. Other electricity retailers include the two State Owned Enterprises, Mighty River Power (Mercury Energy and First Electric brands) and Meridian Energy, Contact Energy

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[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

(Contact Energy and Empower brands), TrustPower, and Todd Energy (FreshStart, Bay of Plenty Electricity and King Country Energy brands).

INDUSTRY BACKGROUND

Electricity Retailing

8. Supply of electricity in New Zealand is undertaken by generators and retailers, which pursuant to Section 17 of EIRA, may not own transmission and distribution assets. On 1 April 1999, retail and lines companies were required to split, with most of the companies choosing to retain their distribution assets and sell their retail customer bases to generators or independent retailers.

9. Retailers of electricity have several requirements in order to compete in the electricity retail market. They require: a sales force, a meter reading function, an administration function that deals with billing and switching, a customer service function, distribution network user agreements, and a supply of electricity.

10. The majority of the electricity generated in New Zealand is traded through the New Zealand Electricity Market ("NZEM"). The administration of the NZEM is conducted by M-co.

11. Spot trading of wholesale electricity began on the NZEM in October 1996. This market operates as a pooling arrangement, under which generators and buyers make price/volume offers and bids for electricity supplied and demanded respectively for discrete half-hourly periods. Bids and offers may be revised up to two hours prior to the trading period. This offer process establishes a dispatch order for generation plant running from lowest priced bid to highest priced bid, and individual plants are generally dispatched in that order until demand in the relevant period is met. The spot price in that period is determined by the price bid by the last power station to be dispatched, called the "marginal station".

12. The market clearing price for each half hour can be subject to significant fluctuations with changes in demand, changes in generation conditions including water storage levels and changes in transmission constraints. To protect themselves against such fluctuations, most retailers take out hedge contracts, or contracts for differences, with major generators.

13. Hedge or bilateral contracts occur between generators and individual retailers or large users outside the spot market. Such contracts may be attractive to both parties through the protection provided against the price volatility involved with spot trading. The two sorts of trading are clearly related, in that fixed prices in bilateral contracts will reflect participants' expectations about spot prices over the period of the contract

MARKET DEFINITION

14. The Act defines a **market** as:

> *. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

15. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

16. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

17. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:

    - the goods or services supplied and purchased (the product dimension);
    - the level in the production or distribution chain (the functional level);
    - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
    - the temporal dimension of the market, if relevant (the timeframe).

18. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

19. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

20. The Applicant has submitted that the relevant market in this instance is the national market for the retail supply of electricity.

Product Dimension

21. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

22. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[2] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

Demand-side and supply-side substitution

23. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

24. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

25. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

26. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

27. The Commission has previously adopted discrete electricity and gas product markets when assessing business acquisitions in the energy sector. The Commission stated in Decision 270:[3]

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[2] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

[3] Decision 270, *Natural Gas Corporation of New Zealand Limited and Enerco New Zealand Limited*, 22 November 1993.

> "None of the evidence presented to the Commission points to a clear cut answer to the market definition problem. However, all of the evidence is consistent with the conclusion that natural gas and other fuels, especially electricity and to a lesser extent coal, are indeed substitutes for each other, both technically and commercially – but they are at best imperfect substitutes, and cannot be regarded as being in the same market". (para129)

28. This approach is consistent with recent decisions of the courts. In the High Court judgment in *Power New Zealand Ltd v Mercury Energy Ltd* (1996) 1 NZLR 686, subsequently upheld in February 1997 by the Court of Appeal, the court said:

> "It is common ground that gas is not in close competition with electricity. We see no reason to question this approach". (p.704)

29. In *Shell (Petroleum Mining) Company Limited v Kapuni Gas Contracts Limited* (1997) 7 TCLR 463, the High Court heard a substantial amount of economic evidence on market definition. It said:

> "We accept that {light fuel oil, coal and electricity} are substitutable {for natural gas} in certain favourable circumstances, but always at the edges and seldom in response to a SSNIP". (p.527)

30. In subsequent decisions[4] the Commission in each case considered it appropriate to adopt discrete product markets for electricity and gas. The Commission recognised that while inter-fuel competition provided some constraint on each energy form, it did not consider the constraint sufficiently strong to include electricity and gas in the same market.

31. The Commission has no evidence to suggest that this product definition has altered in the intervening period, and therefore the Commission concludes that for purposes of assessing the competition implications of the acquisition, the appropriate product market is electricity.

Geographic Extent

32. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

33. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

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[4] Including Decision 330 – NGC/Powerco, Decision 333 – Contact/Enerco, Decision 340 - TransAlta/Contact, Decision 345 – UnitedNetworks/TransAlta, Decision 380 – UnitedNetworks/Orion.

34. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.

35. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

36. The Commerce Act defines a market to be a "market in New Zealand". However, in many markets New Zealand buyers purchase products from both domestic suppliers and from overseas suppliers. Where imported products are close substitutes for domestic products, the overseas suppliers will be part of the relevant market. In such circumstances the Commission, in order to comply with the wording of the Act, is likely to define a national market and then, as discussed later in the competition analysis, to consider the extent to which overseas suppliers exercise a competitive constraint on the participants in the domestic market.

37. The electricity retail market is the market formed between retail suppliers on the one hand and end-users on the other. Prior to the structural reforms arising from EIRA, the Commission considered that there were two such retailing markets: one for larger and medium-sized customers (ie: industrial and larger commercial) with half-hourly meters, which was regarded as contestable (users were not restricted to buying from the incumbent lines operator cum retailer); and one for small customers (ie: small commercial and households), with non-time-of-use meters, which was regarded as non-contestable. The former was defined as a nation-wide market, while the latter was restricted to the area covered by the distribution network of the incumbent retailer. In making this assessment, the Commission considered that:

> …It had not been economically feasible for non-incumbent retailers to compete with incumbent retailers for small customers due to the cost of time-of-use metering and associated equipment being too high in comparison with potential profit margins able to be derived from small customers.[5]

38. In Decisions 333, 340 and 387, the Commission considered the likely effects of the structural reforms and the implications for defining the relevant markets. By Decision 333 in late 1998, the Commission was satisfied that:

> …There is clear evidence of electricity suppliers being able to switch supplies between different categories of consumers, including small consumers, depending on market opportunities. Suppliers do not appear constrained to supplying limited geographical areas or to supplying to consumers on particular networks only. Small consumers now have, or will have in the near future, a choice of suppliers. This situation increasingly matches that of larger consumers. Therefore the Commission concludes that it is no longer appropriate to define discrete markets for the supply of delivered electricity to small consumers and to medium and large consumers. This view is based on the new dynamics in the marketplace arising from:
>
> - the lowered barriers to new entry due to the separation by legislation of electricity lines businesses and supply businesses;

[5] Decision 333, para 28.

- the emergence of significant new players in the marketplace who have signalled their intention to compete against incumbent retailers; and
- the Government's stated commitment to ensuring that small electricity consumers benefit from competition, and its expectation that deemed profiling be introduced (either by the industry participants or, if necessary, by itself) in the near future.[6]

39. In reassessing the previous market definition in Decision 333, the Commission gave particular weight to the intentions of electricity retailers who were marketing electricity to small consumers in competition with incumbent retailers in the larger population areas. Furthermore, the Commission took into account the likely effect the introduction of deemed profiling would have on the economic feasibility of non-incumbent retailers competing with incumbent retailers for small customers.

40. The Applicant has argued that there has been no material change in conditions that would indicate that the geographic extent of the retail market has changed, since the Commission's earlier decisions.

41. Since the inception of electricity retail market competition arising from the structural reforms, the Commission has observed a number of features of the retail market, including:

    - large retailers, including the major generators, took some time to establish processes to ensure smooth transitions for switching customers. This created opportunities for nimble entrants, with flexible billing and customer support platforms to enter and win support from a significant number of customers, eg. Empower (pre-Contact acquisition) Energy Online and Freshstart. These entrants were able to obtain competitive wholesale supply arrangements on an ongoing basis;
    - the exit of On Energy in 2001 from electricity retailing, when it was exposed to high spot prices of electricity during a cold, dry winter. [

      ];
    - consolidation of customer bases (customer-swap between TrustPower and Mighty River Power);
    - information on the degree to which persistent transmission constraint risks may affect behaviour; and
    - vertical integration between generators and retailers.

42. The Commission observes that in general, the retail market has been highly contested, although the vigour of competition has varied over the period April 1999 to the present. By March 2001, the profiling system had enabled around 390,000 retail customer switches to occur.[7]

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[6] Decision No. 333, para 40

[7] Switching numbers supplied by M-co.

43. Switching has generally been at 15,000 – 30,000 customers per month. This represents 1-2% of total retail customers per month, or 10-20% of total retail customers per year. Although the rate in the first part of 2002 shows a decline in transfers from previous peaks, switching has continued well above the rate in 1999, with 870,000 customer switches having taken place to date.

44. The critical factor in determining the geographic extent of markets is the extent to which competitive entry could occur in response to a *ssnip* in a particular region. For successful entry to occur in the electricity retail market, a retailer must have access to wholesale supply of electricity, appropriate distribution use of system agreements, access to meters, and suitable billing and customer support platforms.

45. The Commission has received information that suggests that the ability to enter particular regions is relatively unconstrained. Distribution use of system agreements appear to be generally available, although the Commission cannot rule out the possibility of difficulties in particular areas, wholesale electricity supply contracts are available at appropriate grid exit points [ ]. The existence of transmission constraint risks do not appear to have affected competition to date, although this remains a possibility.

46. The Commission has also considered customer swapping (of approximately 20,000 customers each) by TrustPower and Mighty River Power in February 2002. The impact of this transaction has been for each of these retailers to exit from retailing in certain areas and consolidate their position in others. However, in neither case did those retailers strengthen their positions in a market in which they were the incumbent. Rather, each of them became a "stronger No.2" in the areas in which they acquired customers. Commission staff consider that this points to factors that encourage retailers to attain a critical mass of customers in any particular region or network, but does not point to suppliers being constrained to supply only on particular networks.

47. It appears that there are fixed costs of retailing on any particular network, which must be spread across all customers. These costs include the costs of maintaining information on each network company's tariffs, call centre support for those customers, managing the network company arrangement and so forth. It appears that relative to the margins on small customers, unless a reasonable number of customers are held on each network, the cost of servicing those customers may exceed revenues.

48. However, the costs of retailing on networks with fewer customers, do not appear to constitute a significant barrier to entry. Retailers such as Empower and Energy Online, prior to their sale to generators, have made successful forays into new networks and have established significant customer bases within short periods of time. Empower continues to act in this manner.

49. However, the Commission notes however that neither Empower nor Energy Online have sustained their entry, with both selling their customer base to larger retailers. The Commission considers that there is a trend towards larger scale retail operations with a generation arm.

Evidence on the extent of geographic competition

50. The results of enquiries carried out by Commission staff indicate that electricity suppliers have been engaging in advertising and marketing within regions in which they compete over the period June 2000 to June 2002, typically offering monetary credits to new customers or engaging in direct marketing campaigns to raise brand awareness, either on a national basis or in specific regions. Appendix 1 shows the spread of competitors across each region, according to the Ministry of Economic Development's definitions.

51. Empower, a subsidiary of Contact, has recently commenced aggressive campaigns for retail customers in Wanganui, Wairarapa, and Christchurch in direct competition with its parent company and others. [ ] The presence of such a competitor is likely to constrain the price setting behaviour of market participants.

52. Table 1 below indicates new areas where retailers have expanded since September 2001:

Table 1 - Entry into new regions

Retailer	Geographical Region
Mercury	Northern Northland, Northland, Thames, Counties, Waipa, Waitomo, King Country, Tauranga, Rotorua, Taupo, Hamilton, New Plymouth, Stratford, Hawera, Wanganui, Manawatu
Empower	Wanganui, Christchurch, Wairarapa

53. Apart from the customer swap between TrustPower and Mighty River Power, no other existing competitor has withdrawn from competition in particular regions.

54. Further, entry or expansion in particular areas can occur rapidly. The following table highlights a number of regions where non-incumbents have increased in size markedly over the past year:

Table 2 - Changes in customer share of non-incumbents in particular regions

Retailer	Geographical Region	Percentage Change
Empower	Auckland Central	[ ]
	Thames	[ ]
Genesis	Rotorua	[ ]
Contact	Manawatu	[ ]
	Nelson	[ ]
Energy Online	Hawkes Bay	[ ]
Meridian	Nelson	[ ]
	Mid Canterbury	[ ]

55. The large majority of electricity consumers throughout the country continue to have a choice of supplier and can easily switch between those suppliers. The ability of consumers to switch supplier is further discussed in the competition analysis section of this report.

Circumstances in particular regions

56. As identified above, certain regions appear to have a limited number of active electricity retailers. In general, these have been identified as rural areas with a small number of customers. It appears that the low number of customers and low customer density make these less attractive areas for retailers to try and enter. The Commission has also identified an area where there are specific barriers to entry that have deferred or prevented competition.

57. In the Bay of Plenty, Bay of Plenty Electricity is the only electricity retailer. Other retailers have previously sold electricity in this region but have withdrawn, owing to their inability to gain access to electricity meters.

58. The vast majority of retail customers fall within one large market. However, the Commission has been unable to rule out the possibility that there may be regions or network areas where the imposition of a *ssnip* above competitive levels would not be constrained by timely entry. Such regionally based markets may occur where there are barriers to entry, such as restricted access to meters or significant and persistent risks of transmission constraints that cannot be covered by wholesale supply contracts.

59. For these reasons, the Commission has concluded that it remains appropriate in most instances to assess competition issues affecting the retailing of electricity within the

context of a national market. It would also remain appropriate to adopt narrower markets where a region has peculiar characteristics which, for instance, might impact on new entry into that region.

60. However, as there are a number of competing electricity retailers in the areas in which EOL retails electricity, for the purposes of this application, the Commission considers that the appropriate geographic market is national.

Functional Level

61. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[8] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

62. The Commission has previously defined an electricity product market with functional markets for wholesale electricity supply, transmission, distribution and retailing. The Commission sees no reason to question those functional distinctions in this acquisition.

63. As EOL is a retailer of electricity, the Commission is of the view that the relevant functional dimension for competition analysis of this application is retailing.

The Timeframe

64. Generally, the Commission will view markets as functioning continuously over time. However, where a market is characterised by, for example, infrequent transactions, the Commission may seek to define a separate time dimension as part of its market definition process. Time considerations are also important where there are long-term contracts, and where there are depletable resources.

65. Few, if any, customers have long-term contracts with their electricity retailer. In addition, providing electricity generators can obtain water and gas, the supply of electricity will be continuous over time.

66. Therefore, the Commission does not consider there to be a separate temporal dimension in the electricity retailing market.

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[8] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

Conclusion on Market Definition

67. The Commission concludes that for the purposes of this application, the relevant market is:

The national market for electricity retailing.

COMPETITION ANALYSIS

Substantially Lessening Competition

68. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

69. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[9] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[10]

70. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[11]

71. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.[12]

72. In interpreting the phrase "substantially lessening competition", the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

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[9] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).
[10] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [1993] 1 All ER 289.
[11] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.
[12] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [1987] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

> Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

> This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

73. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

74. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

75. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

76. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[13]

77. The Commission is advised that in the year ending December 2001, EOL had [

]. In this event, [ ].

78. The Commission therefore proposes to use the ownership of EOL's retail customers by another electricity retailer as the counterfactual.

[13] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

Potential Sources of Market Power

79. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

80. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one year time frame.[14] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

81. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

82. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

Conclusion – Competition Analysis Principles

83. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the the acquisition of EOL's customer base by another electricity retailer. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

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[14] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

84. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints that might apply in the national market for electricity retailing under the following headings:

- existing competition;
- potential competition from entry; and
- other competition factors.

ANALYSIS OF EXISTING COMPETITION

Introduction

85. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

86. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

87. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[15]

88. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission's 'safe harbours', an estimation

[15] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

Existing Participants

89. The major participants in the market are:
    - Genesis
    - Meridian
    - Contact – retail brands Contact and Empower
    - Mighty River Power – retail brands Mercury Energy and First Electric
    - TrustPower
    - Todd Energy – retail brands Freshstart Energy, Bay of Plenty Electricity, and King Country Energy
    - Energy Online

Inter-firm Relationships

90. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.

91. The Commission is aware that electricity retailers from time to time meet with the Minister of Energy at the Minister's request. In addition, electricity retailers are members of such industry bodies as the NZEM, and the Electricity Complaints Scheme administered by the Electricity Complaints Commissioner. All of these fora provide various elements of regulatory control on the involved parties, whether implicitly or explicitly. The Commission is of the view that common participation in these industry groups by retailers is unlikely to affect rivalry in the electricity retailing market.

Safe Harbours

92. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

    - where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or

    - where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

93. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

Market Shares

94. The estimated market shares by customer numbers and by load are shown in Tables 3 and 4 below:

Table 3 – Estimated National Market Shares for Electricity Retailing by Customer Numbers

Retailer	**Number of Customers**	**% of Customers**
Contact Energy	[ ]	[ ]%
Genesis	[ ]	[ ]%
Meridian Energy	[ ]	[ ]%
Mighty River Power	[ ]	[ ]%
Todd Energy	[ ]	[ ]%
TrustPower	[ ]	[ ]%
Energy Online	[ ]	[ ]%
TOTAL	**[ ]**	**100%**

95. The current three firm concentration by customer number is [ ]. Post merger, the three firm concentration ratio would be [ ] with the merged entity having a [ ] share. These figures are inside the Commission's safe harbours.

Table 4 – Estimated National Market Shares for Electricity Retailing by Customer Load

Retailer	**Customer Load (GWh)**	**% of Customer Load**
Contact Energy	[ ]	[ ]%
Genesis	[ ]	[ ]%
Meridian Energy	[ ]	[ ]%
Mighty River Power	[ ]	[ ]%
Todd Energy	[ ]	[ ]%

TrustPower	[ ]	[ ]%
Energy Online	[ ]	[ ]%
TOTAL	**[ ]**	**100%**

96. The current three firm concentration by customer load is [ ]. Post merger, the three firm concentration ratio would be [ ] with the merged entity having a [ ] share. These figures are inside the Commission's safe harbours.

97. As already noted, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

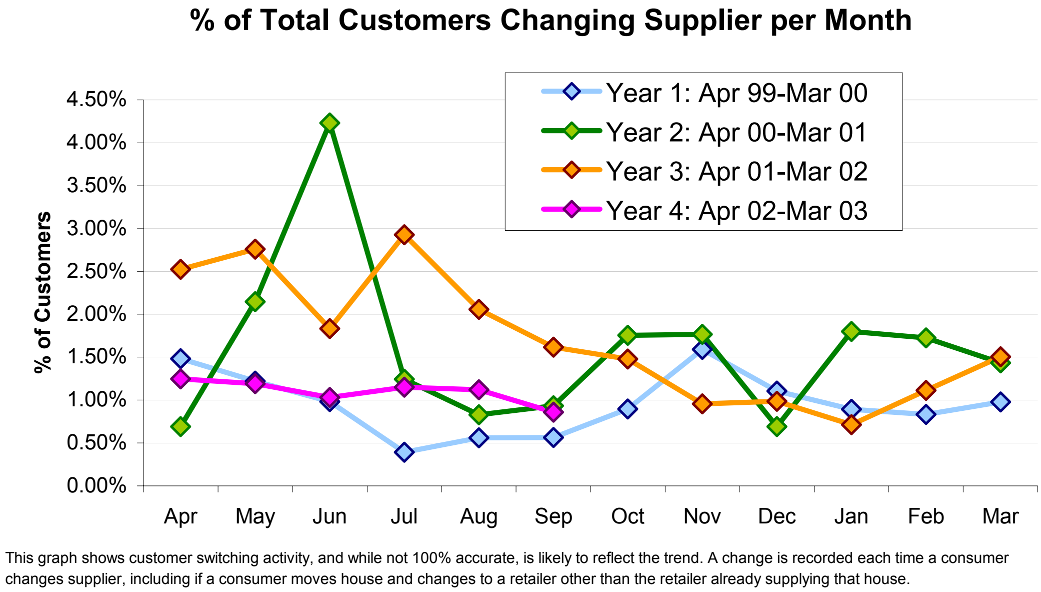
State of Existing Competition

98. The acquisition would result in limited horizontal aggregation with the merged entity increasing its market share by [ ], both by customer numbers and by customer load. Furthermore, the merged entity would continue to face competition from existing participants in the market.

99. Full competition was introduced between retailers on 1 April 1999 by the creation of a new, low cost system for customer switching based on profiling. By March 2001, the profiling system had enabled almost 390,000 customers to switch retailers[16]. The number of customers changing their electricity suppliers over the period 1 April 1999 to 1 May 2002 is examined in Graph 1.

[16] Evolution of the Electricity Industry, Internal Commerce Commission Memorandum, p23

Graph 1



Source: M-co.

100. Graph 1 shows that since the spike in transfers in June 2000 (attributed to the catching up of a back-log) and another peak in April-June 2001, switching has generally been at 15,000 – 30,000 customers per month. This represents 1-2% of total retail customers per month, or 10-20% of total retail customers per year. The rate in the first part of 2002 shows a decline in transfers from previous peaks, but the rate of transfer has continued well above the rate in 1999 and there has continued to be a reasonable rate of customer switching.

101. During the dry winter of 2001, a number of retailers closed their books to new retail customers in some regions. Retailers who were not fully hedged were exposed to prices of around \$150/MWh (peaking at \$989/MWh), compared to an average spot price between May 1999 and March 2001 of \$33/MWh at the Haywards reference node and \$30/MWh at the Benmore reference node. In order to reduce exposure to those prices, retailers had little option but to refuse to take on new customers. Investigations by Commission staff have established that all retailers, with the exception of EOL, are now accepting new customers. Whilst competition was thwarted during the period, the Commission is of the view that the closing of retail books over winter 2001 was a temporary aberration.

102. Subsequently, and particularly in 2002, there are signs that competition is returning to close to the previous level. While the intensity of competition currently varies to some extent throughout the country, the key variable is population density. This is a characteristic of most markets. The other factors affecting competition are generally common to all regions. The major retailers operate nationally. Very limited, if any, physical presence in a particular region is required to operate within that region.

103. Empower and Mighty River Power have recently entered areas where they did not previously compete, thereby offering new competition to the incumbents in those areas. Empower is particularly aggressive in its campaign, offering a \$50 credit and prize

draws to its new customers. Apart from the previously mentioned customer swap between TrustPower and Mighty River Power, recently, no retailer has withdrawn from a region in which it retails electricity.

104. Although retail prices have increased across the country, it is difficult for the Commission to make meaningful comparisons on the size of the increases. In the main, however, they appear to reflect generally higher wholesale prices and the increased perception of risk compared with when prices were last changed.

105. The Commission notes that industry participants commented that the proposed acquisition would have little, if any effect on the state of existing competition.

106. All retailers, with the exception of EOL, are competing for new customers and the major generator/retailers are seeking customers throughout most parts of the country. In addition, customer switching is at a level which is at least comparable with previous years and above the level of switching which occurred when the present market structure was implemented in 1999

Conclusions – Unilateral Market Power

107. The merged entity would be constrained by current competition. The merged entity faces continued competition from a number of existing electricity retailers.

Scope for the Exercise of Coordinated Market Power

Introduction

108. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

109. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination; 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

110. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

111. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

112. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 2. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

Table 5 - Testing the Potential for 'Collusion' in the Electricity Retailing Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	No.
Undifferentiated product	Yes.
New entry slow	No, a new entrant could enter in a relatively short timeframe. (For example Empower and Mighty River Power's apparent ability to enter new areas).
Lack of fringe competitors	No, several fringe competitors exist.
Price inelastic demand curve	Yes.
Industry's poor competition record	No, the current structure of the electricity industry is relatively new. In addition, the industry is governed by the NZEM Rules and MARIA[17].
Presence of excess capacity	Not applicable in this case.
Presence of industry associations/fora	Yes but which provide a degree of regulatory control (see para 91).

113. The assessment of the relevant structural and behavioural conditions in the electricity retailing market in Table 5 suggests that, on balance, the market is not particularly likely to be susceptible to collusion, even after the acquisition. Accordingly, the Commission has found it unnecessary to determine the potential for discipline in the electricity retailing market in this instance.

[17] Metering and Reconciliation Information Agreement: an agreement that outlines the rules that allow a buyer and seller to supply certain amounts of electricity. It also enables consumers to switch suppliers regardless of their location.

Conclusions – Co-ordinated Market Power

114. The Commission concludes that the scope for the exercise of co-ordinated market power in the market for electricity retailing would not be enhanced by the acquisition.

Conclusions – Existing Competition

115. The Commission considers that the market share of the merged entity will be inside safe harbours. In addition, existing competition will alleviate any concerns of unilateral power being exercised by the merged entity.

116. Furthermore, the Commission considers that the scope for the exercise of coordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

117. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

118. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

119. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

120. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

121. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader ‘entry conditions’ that apply, and then go on to evaluate which of those constitute entry barriers.

122. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

123. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

124. For successful entry to occur in the electricity retail market, a retailer must have access to wholesale supply of electricity, appropriate distribution use of system agreements, access to meters, and suitable billing and customer support platforms.

The "LET" Test

125. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

126. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

127. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

128. A wholesale supply of electricity is readily available to electricity retailers through the electricity spot market. Energy Online advised the Commission that it had [

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129. There may be entry barriers relating to distribution company scale, which might deter retailer entry in areas that are less densely populated. According to Mighty River Power, there are high fixed costs of setting up systems to cater for a small number of customers on a small network in relation to the margins on those customers. Accordingly it may not be viable for retailers to compete for customers in any such regions unless the incumbent increases margins to levels that would cover the fixed costs of entry. However, this is a characteristic of most markets.

130. Electricity retailers are of the view that Use of System Agreements ("USAs") offered by the various network companies are generally satisfactory, although they consider that the vast range of USAs, both in number to be negotiated and in the variability of terms and conditions, may impose unnecessary transaction costs on retailers. However, as

these transaction costs are borne by all retailers, the Commission does not consider that they constitute a significant entry barrier.

131. In general, access to electricity meters is readily available. However, as discussed at para 57 above, access to meters in the Bay of Plenty area is presently a barrier to entry in that region.

132. Call centre, billing and customer support functions are typically operated on a national basis, although it is not essential that a participant in the electricity industry provides these functions. For example, Newcall, EOL's parent company, which is involved in the provision of telecommunications services, provides EOL's call centre and customer support function. In addition, electricity retailers advised the Commission that generally they are able to obtain meter reading services at competitive prices, often from the incumbent retailer in a region.

133. Any decrease in service quality or increase in retail prices by an incumbent would likely result in a new entrant adopting a similar business model to EOL, exploiting such actions to enter the market and quickly gain a block of customers with the aim of eventually selling the customers to one of the larger retailers.

Extent of Entry

134. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

135. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firms' efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

136. Empower has demonstrated that entry to the electricity market can be effected on sufficient scale to constrain market participants. The fact that Contact viewed Empower as enough of a threat to purchase Empower is evidence of this. Although Empower is now a subsidiary of Contact, Contact operates Empower as a separate entity, often competing for the same customers.

137. Despite [

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138. The threat of 'cherry picking' new entrants such as Empower and EOL poses considerable constraint on existing participants. Larger retailers such as Genesis and Meridian have advised the Commission that quality customer services, together with market pricing are essential for the retention of customers. [

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139. The Commission concludes that entry can be effected on sufficient scale to constrain the merged entity.

Timeliness of Entry

140. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

141. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

142. Energy Online advised the Commission that entry into the electricity retailing market can be effected within two to three months, once wholesale supply, meter reading and back office functions have been secured, USAs negotiated and a sales force recruited.

143. Other industry participants also advised the Commission that entry to the market could be effected relatively quickly.

144. The Commission concludes that entry to the electricity retailing market can be effected within a reasonably short timeframe.

Conclusion on Barriers to Entry

145. The Commission concludes that there are not sufficient barriers to entry to deter expansion or new entry. Potential competition is likely to provide constraint on the merged entity, and the industry as a whole.

OTHER COMPETITION FACTORS

Elimination of a Vigorous and Effective Competitor

146. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

147. EOL could be regarded as different from other retailers as, unlike the majority of retailers, it is not owned by a generator. However, given the availability of hedges, it is not obvious that this factor means that EOL is significantly different from other retailers. In addition, in early 2002, EOL ceased actively growing its customer base [ ] As a result, marketing and promotional expenditure has ceased. Given these factors, it would appear that the

merging of the entities is unlikely to have a disproportionate effect on competition in the market.

Constraint from Buyers or Suppliers

148. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

149. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

150. Customers are not captive to any particular retailer simply because that retailer has acquired them from another retailer. Customers are able to switch at whim, should they be unsatisfied in any way with their electricity retailer. The only situation that could arise where competition might be substantially lessened is if the only retail competition was between Genesis and EOL, since customers would have no choice of retailer post-acquisition. However, that is not the case in any of the regions in which EOL retails electricity.

151. As previously discussed, when faced with a reduction in customer service, and/or increases in price, customers are willing to switch electricity retailers. [ ]. Recently, Empower has marketed aggressively in a number of areas, offering electricity credits and prize draws to customers that switch to Empower.

152. As such, 1-2% of total retail customers per month, or 10-20% of total retail customers per year are switching electricity retailers. This level has continued well above the rate in 1999, indicating that customers are prepared to, and do, switch retailers.

153. Given the demonstrated ability of retail customers to switch retailers, the Commission is of the view that electricity retail customers will pose some constraint on the merged entity.

Efficiencies

154. The Commission recognises that there may be circumstances where efficiencies are relevant to an application for clearance.[18] In the context of a business acquisition, the combined entity might be able to make efficiency gains that are not obtainable by other means, such that its unit cost of production would decline. This could result in the

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[18] In *Fisher & Paykel*, considered under s 27, the Court held that in assessing "substantial lessening of competition", a net approach to assessing anti-competitive effects was required: "The majority correctly accepted that it had to 'net out' the pro and anti-competitive effects and that, if it could be shown that the net effect of the EDC was to promote competition, then there could be no substantial lessening of competition." *Fisher & Paykel v Commerce Commission* [1990] 2 NZLR 731 at 740. See also: *Commerce Commission v Port Nelson*, supra n 6,433; *Shell (Petroleum Mining) Company Ltd v Kapuni Gas Contracts Ltd*, (1997) 7 TCLR 463, 531.

entity reducing its price below that obtaining prior to the acquisition, even though with the acquisition it would otherwise be considered to have substantially lessened competition, and would be able to raise price above costs.

155. Where the Applicant can make a sound and credible case that such efficiencies will be realised, that they cannot be realised without the acquisition, and that they will enhance competition in the relevant market, the Commission will include them in the broader analysis of all of the competitive effects of the acquisition in the course of assessing whether or not competition is likely to be substantially lessened. However, the Commission envisages that efficiency claims of the required magnitude and credibility will only very rarely overturn a finding that competition would otherwise be substantially lessened.

156. The Applicant has not argued that efficiencies are relevant to this application for clearance. The Commission does not consider that it is necessary to form a view on efficiency gains in the context of this application.

OVERALL CONCLUSION

157. The Commission has considered the probable nature and extent of competition that would exist in the national market for electricity retailing but for the acquisition.

158. The proposed acquisition would result in the merged entity obtaining a market share that falls inside the Commission's safe harbour guidelines.

159. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- existing competition;
- potential competition from entry; and
- other competition factors.

160. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the national market for electricity retailing.

DETERMINATION ON NOTICE OF CLEARANCE

161. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Genesis Power Limited, through its subsidiary GP No.3 Limited, of Energy Online Limited's business of retailing electricity to customers at locations in the North Island, and assets incidental to that business.

Dated this 10th day of October 2002

MJ Belgrave
Chair

Appendix 1: Participation of Electricity Suppliers in Geographical Regions as at May 2002[19]

Region	**Retailers**
Northern Northland	TrustPower, Contact, Meridian, Mercury
Northland	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric
Auckland North/West	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric, Energy Online
Auckland Central and Manakau	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric, Energy Online
Counties	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric,
Thames	TrustPower, Contact, Mercury, Genesis, First Electric, Energy Online, Bay Of Plenty Electricity
Waipa	TrustPower, Genesis, Meridian, Energy Online
Waitomo	TrustPower, Genesis, Meridian, King Country Energy
King Country	Genesis, King Country Energy
Hamilton	TrustPower, Contact, Meridian, Genesis, First Electric, Energy Online
Tauranga	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric, Energy Online, Bay Of Plenty Electricity
Rotorua	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric, Energy Online, Bay Of Plenty Electricity

[19] Empower, a wholly owned subsidiary of Contact, is not differentiated from Contact for the purposes of this analysis.

Taupo	TrustPower, Contact, Meridian, Mercury, Genesis, First Electric, Energy Online, Bay Of Plenty Electricity, King Country Energy
Bay of Plenty	Bay of Plenty Electricity
Eastland	TrustPower, Contact, Meridian, Genesis
Wairoa	TrustPower, Meridian, Empower
Hawkes Bay	Contact, Genesis, Meridian, Energy Online
Central Hawkes Bay	TrustPower, Contact, Genesis, Meridian
Southern Hawkes Bay	Genesis, Meridian,
Wairarapa	TrustPower, Contact, Genesis, Meridian, First Electric, Todd Energy
New Plymouth, Stratford, Wanganui	TrustPower, Contact, Genesis, Meridian, First Electric, Todd Energy
Hawera	TrustPower, Genesis, Meridian, Todd Energy
Manawatu	TrustPower, Contact, Genesis, Meridian, Todd Energy
Horowhenua/Kapiti	TrustPower, Contact, Genesis, Meridian
Wellington North	TrustPower, Meridian, Mercury, First Electric
Wellington South	TrustPower, Contact, Genesis, Meridian, Mercury, First Electric, Todd Energy
Nelson	TrustPower, Contact, Meridian
Tasman	TrustPower, Contact, Genesis, Meridian
Marlborough	TrustPower, Genesis, Meridian
Buller	TrustPower, Meridian

Westland	TrustPower, Genesis, Meridian
North Canterbury	TrustPower, Contact, Genesis, Meridian
Mid Canterbury	TrustPower, Meridian
Christchurch	TrustPower, Contact, Genesis, Meridian, First Electric
Ashburton	TrustPower, Contact, Genesis, Meridian
South Canterbury	TrustPower, Contact, Genesis, Meridian
Waitaki	TrustPower, Genesis, Meridian
Central Otago	TrustPower, Contact, Meridian
Otago	TrustPower, Contact, Genesis, Meridian
Dunedin	TrustPower, Contact, Genesis, Meridian
Southland	Contact, Genesis, Meridian
Invercargill	TrustPower, Contact, Genesis, Meridian