

PUBLIC VERSION

ISSN NO. 0114-2720
J3118

Commerce Commission

Decision No. 330

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

Natural Gas Corporation of New Zealand Limited

and

Powerco Limited

The Commission: Dr Kate Brown
Cathie Harrison
Liz Coutts
Paula Rebstock

Commission Staff: Andrew Brice
Kathy James
Dick Adam

Determination: Pursuant to s 66(3)(a) of the Act, the Commission determines to give a clearance for the proposed acquisition.

Date of Determination: 11 November 1998

**CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE
BRACKETS**

TABLE OF CONTENTS

THE PROPOSAL	3
THE PROCEDURES	3
THE PARTIES	3
NATURAL GAS CORPORATION.....	3
FLETCHER CHALLENGE LIMITED	4
AUSTRALIAN GAS LIGHT	4
NGC AND ASSOCIATED PERSONS.....	4
POWERCO	4
BACKGROUND TO THE NATURAL GAS INDUSTRY	5
RECENT DEVELOPMENTS	6
MARKET DEFINITIONS	7
DEFINING MARKETS IN GAS RELATED CASES	7
THE APPLICANT’S VIEW	8
GAS OR ENERGY PRODUCT MARKET	8
FUNCTIONAL MARKETS	9
THE TRANSMISSION OF GAS.....	10
THE WHOLESALING AND RETAILING OF GAS	10
SUMMARY	11
COMPETITION ANALYSIS	12
THE TRANSMISSION MARKET.....	12
THE WHOLESALE MARKET	12
THE RELEVANT MARKET	14
CONCLUSION	15
RECOMMENDATION	15
DETERMINATION ON NOTICE OF CLEARANCE:	16
APPENDIX I: NATURAL GAS CORPORATION	17
APPENDIX II: GAS FLOW SUMMARY	18
APPENDIX III: GAS SALES	19

THE PROPOSAL

1. Natural Gas Corporation of New Zealand Ltd (NGC) has applied in terms of s 66 of the Act, for clearance to acquire the gas trading assets of Powerco Ltd (Powerco).
2. The assets to be acquired comprise Powerco's list of gas customers: that is NGC will acquire the right to supply gas to and bill the customers connected to Powerco's gas distribution network. Powerco will retain ownership of the distribution network and associated meters.

THE PROCEDURES

3. The notice was registered on 13 October 1998.
4. Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension was sought by the Commission and agreed to by the applicant. Accordingly a determination is required by 11 November 1998.
5. NGC sought confidentiality for certain information contained in the notice seeking clearance, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act will apply to that information.
6. This report concludes that staff are satisfied that the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market. Accordingly, it is recommended that in terms of s66(3)(a) of the Act, the Commission give clearance for the proposal.

THE PARTIES

Natural Gas Corporation

7. NGC undertakes the business of the acquisition, transmission and marketing of natural gas throughout the North Island. NGC operates at the distribution and retail level directly in Northland, Waikato, Bay of Plenty, Taupo, Gisborne, Taranaki and Kapiti. It has a 25.1% interest in the Wanganui gas distributor and retailer, Wanganui Gas Ltd. NGC also owns 50% of the Kapuni Energy joint venture, which undertakes electricity and steam generation at the Kapuni gas treatment plant site. A diagram showing the structure of the NGC Group is attached as Appendix I.
8. NGC is wholly owned by Natural Gas Corporation Holdings Ltd (NGC Holdings), which is a listed public company. NGC Holdings is owned:
 - 33.3% by Fletcher Challenge Utilities Investments Ltd, a member of the Fletcher Challenge Group of companies;
 - 33.3% by members of the Australian Gas Light group of companies (29.79% by AGL NZ Ltd and 3.55% by AGL NZ Investments Pty Ltd); and
 - 33.3% by the public.

9. On 6 November 1998, the Board of NGC announced that it was considering a proposal to restructure its businesses which would place into three separate companies (with different ownership) transmission, marketing and distribution, and processing and co-generation. The proposal, if put into effect, is likely to lessen the present level of vertical integration in the sector. It is not expected that it would impact adversely on the competitive effects of the current proposal.

Fletcher Challenge Limited

10. Fletcher Challenge Limited (FCL) is a New Zealand based international company with operations in building, energy, forests and paper. Targeted shares representing each division are listed on the New Zealand, New York and Australian stock exchanges.

Australian Gas Light

11. The Australian Gas Light (AGL) group of companies is involved in most facets of the gas industry in Australia, including the ownership and operation of gas pipelines and the distribution and marketing of natural gas to domestic, commercial and industrial consumers. In New Zealand, AGL has a management contract with NGC to manage the distribution and retail businesses of NGC.

NGC and associated persons

12. The Commission has previously expressed the view that FCL and NGC are associated persons, as defined in s 47(3) of the Act. FCL holds 33.3% of the shares in NGC. It has an agreement with AGL together to use best endeavours to control NGC's Board, and FCL is an important supplier of gas to NGC.
13. The analysis below treats FCL and NGC together in terms of their market power in the relevant gas markets.
14. NGC has a 25.1% share holding in Wanganui Gas. For the purposes of the competition analysis in this matter, Wanganui Gas and NGC are regarded as associated persons.

Powerco

15. Powerco Ltd is a power and natural gas company which generates, distributes and retails electricity in Taranaki, Wanganui and Rangitikei, including the cities of New Plymouth and Wanganui and the towns of Waitara, Stratford, Hawera, Marton, Bulls, Taihape, Waiouru and Raetihi. In addition, Powerco distributes and retails natural gas in north Taranaki in New Plymouth, Bell Block and Waitara, and in South Taranaki in Hawera, Manaia, Okaiawa and Normanby.
16. Powerco's shareholders are:

Shareholder	%
Pukeariki Holdings Ltd	50.4
Taranaki Electricity Trust	13.6
IES New Zealand Ltd	9.2
Powerco Community Trust	4.3
Other public shareholders	22.5
	100.0

17. Powerco owns and operates three different electricity networks. These are located in the New Plymouth City region, the Taranaki rural region and the Wanganui City/Rangitikei rural region. Powerco generates electricity from five hydro power stations embedded into its networks.
18. Powerco has about 16,400 natural gas connections. Powerco's total volume of natural gas sales in the year ended 31 March 1998 was 2.17 PJ, with revenue from gas retailing totalling \$7.3 million and from gas distribution totalling \$9.1 million. Of sales to customers connected to its own network, [] PJ was used by Kiwi Co-operative Dairies Ltd (Kiwi), [] PJ by McKechnie Metals and the balance by other commercial and domestic consumers.
19. Powerco retails natural gas to Affco Ltd's Wanganui works ([] PJ in 1997/98), which is connected to the natural gas network of Wanganui Gas Ltd. It also wholesales natural gas to Pacific Energy Ltd ([] PJ, in 1997/98). Pacific Energy Ltd is moving its activities away from involvement with electricity and natural gas retailing and advised that it was in the process of assigning the gas retail contract to another party [].

BACKGROUND TO THE NATURAL GAS INDUSTRY

20. The four major sources of natural gas in New Zealand are the Kapuni on-shore field, the TAWN¹ group of on-shore fields, the McKee/Kaimiro on-shore field and the Maui off-shore field. These fields account for approximately 20%, 4%, 5% and 70% respectively of New Zealand's annual natural gas production.
21. In terms of the Maui Gas Contract, the entire production of the Maui field² is sold to the Crown. The Crown, under the back-to-back agreements concluded in July 1990, on-sells the natural gas to NGC, Methanex NZ Ltd³ (Methanex) and Contact Energy Ltd (Contact).
22. The Kapuni Gas Contract was the subject of litigation between the Kapuni mining companies⁴ and Kapuni Gas Contracts Ltd/NGC as to the ownership of the remainder of natural gas in the field. The Court's decision divided the remaining Kapuni gas reserves evenly between the field owners (the Kapuni mining companies), and Kapuni Gas Contracts Ltd (a subsidiary of FCL). Kapuni Gas Contracts Ltd on-sells Kapuni gas to Methanex, Petrochem and NGC. The entire production from the McKee/ Kaimiro fields is currently used by Methanex. TAWN production is contracted to Contact which has an obligation to on-sell that gas to Fletcher Challenge Energy to fuel the Taranaki combined cycle power station at Stratford.
23. As shown in the diagram from the Ministry of Commerce publication⁵ attached as Appendix II, about 43% of all natural gas produced is currently used for electricity generation, 36% for petrochemical manufacture, and 21% for the reticulated sector.

¹ The Tariki, Ahuroa, Waihapa and Ngaere fields in central Taranaki.

² Currently about 170 petajoules per annum.

³ For use in its Synfuels and Petralgas plants.

⁴ Shell (Petroleum Mining) Company Ltd and Todd Petroleum Mining Company Ltd

⁵ *Energy Data File*, Ministry of Commerce, July 1998

24. Natural gas is transmitted by NGC's high pressure natural gas pipeline systems between Kapuni/Maui and local, low pressure, distribution networks in Wellington, Hawkes Bay, Bay of Plenty, Gisborne, the Waikato, Auckland and Northland. The Oaonui to Huntly Maui high pressure natural gas transmission pipeline is operated by NGC for the Maui Joint Venture. The other high pressure transmission pipelines are all owned and operated by NGC.
25. The NGC high pressure transmission system delivers natural gas to 15 separate reticulated, low pressure, distribution systems in the areas mentioned above as well as directly to a number of large natural gas consumers, including power stations.
26. Historically, distribution and retailing functions were undertaken by gas utilities within exclusive franchise areas. Powerco operates at the distribution level of the industry in North and South Taranaki. Other utilities are owned by Enerco NZ Ltd (Enerco), TransAlta NZ Ltd (TransAlta), Wanganui Gas and NGC.

Recent Developments

27. From 1 April 1993, statutory gas franchises were removed and price control was lifted from the wholesale and retail sectors. Changes to the sector have occurred only slowly since then, with a number of longstanding issues finally being resolved in 1997. These were:
 - The supply contracts between NGC and the gas utilities were renegotiated, removing the clauses which the Commission had considered anti-competitive, such as a requirement to acquire gas exclusively from NGC. The new contracts also unbundled gas supply from transmission services;
 - The judgment of the Court on the Kapuni litigation was handed down on 3 February 1997; and
 - The Gas (Information Disclosure) Regulations came into force on 7 August 1997.
28. In 1998, Gas House, a voluntary group with membership across all levels of the gas industry, issued a pipeline access code, designed to promote the development of competitive gas markets by facilitating neutral and non-discriminatory access to pipelines.
29. Another factor has been the establishment in 1996 of Contact, which was formed as a result of the Government splitting Electricity Corporation of New Zealand Ltd (ECNZ). ECNZ's Maui gas contract entitlements were passed to Contact, meaning that it had an obligation to purchase more gas than it required for its own generation requirements.
30. Contact's Statement of Corporate Intent for the year ending 30 September 1998 states:

Contact's core business is primarily the generation, marketing and trading of electricity and the purchase, marketing and trading of gas.
31. As well as creating a new electricity generator, the formation of Contact has resulted in an alternative, though still evolving, gas supplier for utilities and end users. It appears that Contact will also move into the retail market, as it has recently been announced that, subject to approval by shareholders (and the Commission), the Enerco Board has agreed to sell its gas retail activities to Contact. The sale is to include Enerco's customer base of 109,000 customers (excluding industrial users), metering equipment, gas purchase contracts and outstanding receivables.

32. The attached diagram⁵ (Appendix II) shows separate volumes of gas for non-energy use, electricity generation, and the reticulated sector, made up of industrial, commercial, domestic and transport users. Deregulation and the subsequent events have had the effect that there is no longer strict separation of the various sectors of gas users. Gas is now traded between the sectors.

MARKET DEFINITIONS

33. Section 3(1A) of the Act provides that:

“... the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.”

34. In undertaking an assessment of a business acquisition proposal, the Commission seeks to define relevant markets in a way which best assists the analysis of the competitive impact of the acquisition under question.

35. The Commission’s *Business Acquisition Guidelines 1996* define a market for the purpose of competition analysis as:

“... the smallest space, defined in terms of:

- the products or services bought and sold;
- the geographic area from which those goods or services are obtained and supplied;
- the functional level at which transactions take place; and, where appropriate,
- the time period;

within which the hypothetical profit-maximising sole supplier of a good or service would impose at least a small yet significant and non-transitory increase in price (*ssnip*), assuming all other terms of sale remain constant.”

Defining Markets in Gas Related Cases

36. In the past five years the Commission has determined three significant applications involving the gas sector:

- Decision 270 of 22 November 1993 (NGC/Enerco);
- Decision 272 of 22 December 1993 (Enerco/Progas); and
- Decision 302 of 21 July 1997 (Powerco/Egmont Electricity).

37. In Decision 270, the Commission concluded that there was a discrete gas product market (as opposed to an ‘energy’ market as claimed by the applicant). The principal markets used in the analysis in that case were:

- the national gas production market;
- the national gas transmission market;
- gas distribution markets corresponding to the networks of NGC and Enerco;
- the national gas wholesale market;
- the gas retail market corresponding to the networks of NGC and Enerco.

38. In Decision 272, the Commission again used a gas product market, essentially adopting the same markets used in NGC/Enerco, although the production and transmission functional elements were not considered relevant in that case, and the only distribution and retail markets were those corresponding with the networks of Progas and Enerco.

39. In Decision 302, the Commission considered that the principal relevant gas market was that for the local supply of delivered natural gas to small commercial and domestic consumers connected to Powerco's natural gas distribution network in South Taranaki.

The Applicant's View

40. In the application before the Commission, NGC has stated that the relevant markets can be identified as:
- the North Island gas transmission market,
 - the North Island gas wholesaling market, and
 - the gas retail market defined by the boundaries of the previous franchised areas.
41. NGC states that these are the markets identified by the Commission in previous decisions. It notes that it does not accept the appropriateness of the market definitions, but believes that the requirements for a clearance are met even if these market definitions are used.
42. In Appendix 2 to the application, NGC argues that an analysis of the presence or absence of market power would be better served by:
- defining the markets by broader geographic area;
 - ceasing to distinguish between the wholesale and retail function;
 - encompassing gas and electricity within the one product market.

Gas or Energy Product Market

43. NGC has suggested that other sources of energy such as electricity, coal and fuel oil are substitutable and compete with gas and therefore fall within the same product market as gas. NGC has stated, however, that the requirements for a grant of a clearance are satisfied even if a gas product market is used.
44. NGC has not provided new material to support the wider product market claim. Rather it is understood that it is largely relying on a statement in para 215 of the Commission's Decision 302 (Powerco/Egmont Electricity) that:
- “electricity places a constraint on the activities of natural gas companies.”
45. The Commission's position on product market definition is spelt out in that Decision in paragraphs 98 to 104. It noted the view of the Commission in Decision 270 (NGC/Enerco) when substantial submissions were made on the question of product market definition. The Commission said in that decision:
- “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.”
46. This approach is consistent with recent decisions of the High Court. In *Power New Zealand v Mercury* (in a decision which was 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.”

47. In *Shell (Petroleum Mining) v Kapuni Gas Contracts Ltd* in February 1997, the High Court heard a substantial (the Court strongly suggested excessive) 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.”
48. In making the comment that electricity places a constraint on gas companies, the Commission in Decision 302 did not suggest that the constraint was strong enough to place gas and electricity in the same market. To the contrary, the Commission adopted a discrete natural gas product market.
49. Neither the applicant nor industry enquiries have provided additional information that indicates a change from the Commission’s and the High Court’s previous approach is warranted. Therefore, gas product market definitions have been used.
50. Any constraint on market power which is shown to arise from the presence of other energy forms will be considered in the competition analysis.

Functional Markets

51. The gas sector can be divided into a number of functional elements. These elements have been identified in the past as
- Prospecting;
 - Exploration;
 - Production;
 - Transmission;
 - Distribution;
 - Wholesaling; and
 - Retailing.

Prospecting

52. Powerco is not involved at this functional level and therefore the acquisition is unlikely to affect this market. This functional level is therefore not further considered.

Exploration

53. Powerco is not involved at this functional level and therefore the acquisition is unlikely to affect this market. This functional level is therefore not further considered.

Production

54. Powerco is not involved at this functional level and therefore the acquisition is unlikely to affect this market. This functional level is therefore not further considered.

Distribution

55. The proposed acquisition involves the gas trading assets of Powerco. In essence this is Powerco’s gas customer list and its actual or implied contracts with those customers.

56. Powerco is retaining ownership of its low pressure distribution network. While NGC will have contractual access to the network (including billing customers line charges on their energy invoice), Powerco is not restricted from entering contracts with new entrants seeking to compete with NGC. The proposed introduction of deemed profiling will increase the likelihood of new entry.
57. As there is no change in ownership of the distribution network, nor any increase in ownership concentration, this functional level is therefore not further considered.

The Transmission of Gas

58. NGC makes available what it states is neutral and non-discriminatory access to the transmission pipelines. The pricing regime is not region specific.
59. Consistent with past practice, the Commission will continue to use a North Island market for the consideration of the impact of the proposal on the transmission of gas.

The Wholesaling and Retailing of Gas

60. NGC has noted that the Commission has used separate wholesale and retail markets in the past. NGC has therefore addressed the competition issues arising from the proposed acquisition separately for wholesaling and retailing. However it has argued in Appendix 2 to the application that wholesaling and retailing now fall within the one functional market and should properly be considered together for the purpose of competition analysis.
61. It bases this view on the fact that gas markets are becoming increasingly contestable and that suppliers at one functional level are able to also supply to other functional levels.
62. In Decision 302, the Commission defined the wholesale market as encompassing sales to natural gas utilities, natural gas retailers and medium and large industrial consumers. It did this in recognition of the point that NGC has made in the current application, that these gas users are able to switch their source of gas to the range of other firms supplying gas purchasers in these categories. The geographic scope of the market was considered to be the North Island.
63. In Decision 302 the Commission also used a market which it defined as that “for the supply of delivered natural gas to small consumers connected to Powerco’s South Taranaki natural gas distribution networks”. This market definition reflected the Commission’s view at that time, that for small gas users the supply of gas was inevitably tied to the distribution of gas. The transaction costs and the cost of metering meant that new entry into the retail market for small consumers was unlikely to be viable.
64. The Commission remains of the view that significant consumers of gas are likely to have a range of potential suppliers. There appears to be improved access to NGC’s transmission network and to local distribution networks, , while transaction costs and metering costs are not as significant to consumers of this size.
65. Smaller gas consumers appear to continue to be reliant on their traditional supplier, that is the incumbent gas utility. This reliance is likely to lessen as distribution and retailing are separated and particularly if a regime for deemed profiling is introduced (as NGC states is envisaged for early 1999). At that stage it is possible new retailers may enter

the market. Whether they are likely to be firms currently involved in supplying gas at the wholesale level, or whether they will be specialist retailers, remains to be seen.

66. It is noted that NGC has indicated that it will bill its customers on the Powerco network an amount that covers both line and gas prices. That is, its customers will be charged for delivered gas – they will not pay separate amounts to Powerco for distribution and to NGC for the gas.
67. At this time it is considered that it is appropriate to maintain the market definitions used in Decision 302. The characteristics of retailing to small consumers appear quite distinct from those associated with selling to larger customers. This may change as small consumers become more contestable (with deemed profiling, for example) but this is not yet certain.
68. This lead to the question of what is the appropriate dividing point between small and medium consumers. NGC has suggested that currently customers taking more than 10 TJ (10 TJ is the amount that might be used by a medium size dry cleaner, for example) are contestable. Enerco and TransAlta have suggested that the cut-off point would be lower. Wanganui Gas indicated that it might be 6 TJ at the time of the Powerco/Egmont Electricity decision. As the appropriate dividing point is not considered critical to the Commission's consideration of the application, the more conservative figure of 10 TJ has been used in this analysis.
69. It is concluded that for the purpose of analysing the current application it is appropriate to define the following two markets:
 - the North Island natural gas wholesale market which encompasses sales to natural gas utilities, natural gas retailers and medium and large industrial consumers; and
 - the supply of delivered natural gas to small commercial and domestic consumers connected to Powerco's natural gas distribution networks.
70. Strictly speaking, the transactions whereby the Crown sells Maui gas to NGC, Contact and Methanex, fall within the 'wholesale' category. Because of the size of these transactions and the comprehensive influence of the long term contracts under which the gas is acquired, they have not been included in the wholesale market in the following analysis. Full recognition has been given in the competition analysis, however, to the influence they have on the wholesale market.

Summary

71. In summary it is considered that the markets relevant to the consideration of the application are those for:
 - the transmission of natural gas in the North Island (the transmission market);
 - the wholesaling of natural gas in the North Island, encompassing sales to gas retailers and to medium and large industrial customers (the wholesale market); and
 - the supply of delivered natural gas to small commercial and domestic consumers connected to Powerco's natural gas distribution network (the retail market).

COMPETITION ANALYSIS

The Transmission Market

72. The transmission pipelines are expensive to install and are characterised by a high level of sunk cost. It is considered that they have natural monopoly characteristics; new entry by a competing transmitter is considered most unlikely. The Commission has concluded in the past that NGC is dominant in the gas transmission market and nothing has occurred to alter that conclusion.
73. In Decision 270, the Commission found there were a number of factors which placed some constraint on the market power NGC derived from ownership of the transmission network. These included information disclosure requirements, the threat of regulation and the countervailing power of major customers, such as Enerco. The Commission concluded that if Enerco was acquired by NGC it would remove Enerco's countervailing power which provided a small but real constraint on NGC in the transmission market. Accordingly the Commission found that the acquisition would be likely to result in a strengthening of NGC's dominance in that market.
74. It is considered that NGC's acquisition of Powerco's trading assets would not strengthen NGC's established market power. Powerco's gas trading volume is about 12% of the size of Enerco's and there are now other substantial users of the transmission network (Contact, TransAlta, Nova Gas, Shell/Todd for example). In addition, there are factors which may limit the extent to which NGC can exercise its market power which were not present at the time of the NGC/Enerco decision. NGC has introduced what it states are "neutral and non-discriminatory" access terms, the Gas (Information Disclosure) Regulations were introduced last year⁶, and the threat of government intervention in response to any misuse of market power is perceived to be more real now (because of the experience of the electricity sector) than it was in 1993.
75. Having regard to all these factors, it is not considered that the removal of Powerco as a purchaser of NGC's transmission services will have a sufficient material effect on NGC's established market power in the transmission market. It is not considered the acquisition would materially impact on the transmission market in other ways.
76. It is therefore concluded that the proposed acquisition would not result and would not be likely to result in any strengthening of NGC's dominant position in the market for the transmission of natural gas in the North Island.

The Wholesale Market

77. Transactions in this market involve acquisitions of natural gas by resellers and by medium to large final users (ie: those who take in excess of 10 TJ per annum). In some instances resellers on-sell to other resellers. In other instances those who acquire gas principally for their own use sell any gas which is surplus to their requirements to other end users or resellers. It is considered that the potential for buyers in this market to switch suppliers and to trade amongst themselves mean that they all face common market conditions and can be considered within the one 'wholesale' market.

⁶ Which while still to be proven, may provide some minimal constraint on NGC

78. Examples of the range of parties involved and their transactions are:
- Enerco now takes part of its gas requirements from Contact (approximately 8 PJ per annum), in addition to NGC (approximately 10 PJ per annum);
 - Shell/Todd has replaced Powerco in supplying approximately 5 PJ per annum to Kiwi Co-Operative Dairies Ltd;
 - Contact will replace NGC in supplying approximately 1.8 PJ per annum to the New Zealand Dairy Group; and
 - Nova Gas has replaced TransAlta in supplying approximately 170 TJ per annum to Lever Rexona.
79. Commission staff have obtained additional information from NGC on sales in this market. The information is broadly in line with other information held by the Commission. Table 1 below shows total sales in this market, excluding sales to subsidiaries and associated companies (NGC to NGC utilities, for example). A further breakdown of sales is shown in the tables in Appendix III.

Table 1: Combined Sales	PJ	%
NGC	[]	[]
Powerco	[]	[]
Enerco	[]	[]
Shell/Todd	[]	[]
Contact	[]	[]
ECNZ	[]	[]
TransAlta	[]	[]
Pacific Energy	[]	[]
	69.7	100.0

80. Table 1 shows that NGC and Powerco together, in the year ended 30 June 1998, account for []% of all sales in this market. However, if account is taken of the greater amount of gas which Enerco will source from Contact, rather than NGC in the current year, the combined share of NGC and Powerco falls to []%.
81. New entry into the market is principally dependent on access to gas and satisfactory access to distribution and transmission networks. Transparent access regimes are now in place and recent examples of entry indicate that access to networks does not amount to an insurmountable barrier to new entry.
82. The ability to access gas in the future will be dependent on the life of the existing gas fields and on new discoveries. The output of existing fields is committed to a variety of parties, most of whom (FCE, NGC, Shell/Todd, Contact) have shown a willingness to supply new entrants in the market. [

] It is anticipated that the major gas production fields will continue to produce well into the next decade. The Mangahewa field (owned and controlled by FCE) and the Wairoa field (Enerco), both of

which are currently undergoing appraisal testing, may or may not provide viable new sources of gas.

83. In the foreseeable future, it is not considered that the need to find a source of gas provides a significant barrier to entry into the wholesale market.
84. The proposed acquisition would result in only a minor amount of market aggregation in this market. Currently Powerco is only a small player and its ability to influence the market is much less than Contact, Shell/Todd, Enerco and TransAlta for example. New entry has occurred on a reasonable scale over the past two or three years (for example Contact, Shell/Todd, Nova Gas) and additional new entry would not appear to face high entry barriers.
85. While NGC will remain a powerful player in this market, it is considered that the acquisition would not result and would not be likely to result in any acquisition or strengthening of dominance in the market for the wholesaling of natural gas in the North Island, encompassing sales to gas retailers and to medium and large industrial customers.

The Retail Market

86. This market encompasses the supply of gas to those consumers who, to date at least, have not been contestable. Transaction costs and the costs associated with meters have meant that it has not been viable for consumers of this size to switch suppliers, even if alternative suppliers were available.
87. Sales of gas to small consumers throughout the North Island (ie: in various geographic markets) are shown in Table 2:

Table 2: Sales to Small Consumers in North Island Markets	PJ
NGC	[]
Wanganui Gas	[]
Powerco	[]
Enerco	[]
TransAlta	[]
	11.4

88. At present, Powerco has 100% of the small retail market corresponding with its network. It is likely that changes in the industry will permit a greater level of competition in this market than has occurred to date. The application notes that it is envisaged that a regime for deemed profiling (which obviates the need for sophisticated metering) will be agreed to by the gas industry in early 1999. It is possible that if an industry agreement is not reached, government intervention may force it upon the industry as it has with electricity. It is possible that some firms entering the electricity retail market will look to also compete for small gas customers to achieve economies of scope. Contact's recently announced successful bid for Enerco's retail assets is understood to be partly driven by this aim.

89. In the case of the Taranaki region, it is anticipated that the sale by Powerco of its gas trading assets will facilitate competition for customers on its network. Without the split it is possible that prospective new entrants will be deterred from entry because they will be reliant on a competitor from carrying their gas, even if satisfactory use of system agreements are in place. With the separation of distribution from retailing, the distributor is likely to have a much greater incentive to attract new traders on to its network than would be the case if it was also operating in the retail market.
90. Thus, while the market is not competitive at the moment, it is expected that at least some of the customers in the market are likely to have competitive options in the future.
91. However, it is likely that some competition will be likely to develop in the retail market in the near future. The sale by Powerco of its gas trading business will be likely to facilitate this, irrespective of whether the acquirer is NGC or another person. It is considered that if the acquirer of the business is NGC, this will not hinder or delay this development.
92. Consequently it is concluded that the proposed acquisition would not result and would not be likely to result in any acquisition or strengthening of dominance in the market for the supply of delivered natural gas to small commercial and domestic consumers connected to Powerco's natural gas distribution network.

CONCLUSION

93. Staff have considered the impact of the proposal in the three relevant markets:
- the transmission of natural gas in the North Island;
 - the wholesaling of natural gas in the North Island, encompassing sales to gas retailers and to medium and large industrial customers; and
 - the supply of delivered natural gas to small commercial and domestic consumers connected to Powerco's natural gas distribution network.
94. Having regard to the factors set out in s 3(9) of the Act and all the other relevant factors, staff conclude that the proposal would not result, and would not be likely to result, in NGC or any other person acquiring or strengthening a dominant position in a market.

RECOMMENDATION

95. Staff recommend that, in terms of s 66(3)(a) of the Act, the Commission give clearance to the proposed acquisition.

G Thorn

11 November 1998

DETERMINATION ON NOTICE OF CLEARANCE:

NATURAL GAS CORPORATION OF NZ LTD/POWERCO LTD

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3) of the Commerce Act 1986, we hereby give/decline to give clearance for the acquisition by Natural Gas Corporation of New Zealand Ltd of the gas trading assets of Powerco Ltd.

Dr K M Brown

E C A Harrison

E M Coutts

P R Rebstock

Dated this day of November 1998

APPENDIX I: NATURAL GAS CORPORATION

Principle Business Activities & Operational Structure

Commercial Group		Gas Transmission Operations	Gas Transmission Services	Gas Sales & Distribution	Investments
Gas Acquisition & Wholesaling	Gas Processing				
Purchases natural gas from the Maui, Kapuni and McKee fields	Operates gas treatment and conditioning plants at Kapuni	Operates 2,300 km of high pressure gas pipeline and associated facilities owned by NGC	Provides open, non-discriminatory access to the transmission pipeline system and offers contracts for transportation services	Markets and sells natural gas to industrial, commercial, residential and CNG customers	Holds a gas loan investment in Fletcher Challenge Gas Holdings Ltd
Sells processing services at the Kapuni gas treatment plant and sells co-products produced at the plant	Produces co-products of carbon dioxide, LPG and natural gasoline	Operates 313km of high pressure pipeline owned by Maui Development Ltd		Operates over 2,400km of low pressure gas pipeline and associated facilities owned by NGC	Shareholding in: <ul style="list-style-type: none"> • Liquegas Ltd (25%) • Wanganui Gas Ltd (25.1%) • Propane Gas Ltd (49%) • Kapuni Energy (50%)
Purchased entitlements to 262.5 PJ advance paid Maui gas for \$235m in July 1990		Manages 360km of easements for petroleum product pipelines owned by other companies		Provides open access transportation services on the NGC distribution systems	
Sells gas to utility distributors and other large customers throughout the North Island		Provides specialist services in meter testing and maintenance, and corrosion protection of steel pipes			
Pre-paid gas entitlements					

APPENDIX II: GAS FLOW SUMMARY

Source: *Energy Data File*, Ministry of Commerce, July 1998

APPENDIX III: GAS SALES

These tables show sales for the year ended 30 June 1998. All data is sourced from the applicant and industry enquiries.

Table A.1: Sales to Resellers	PJ	%
NGC (including sales to NGC utilities)	36.1	88.5
Contact ⁷	4.1	10.0
Shell/Todd ⁸	0.5	1.3
Powerco	0.1	0.2
	40.8	100.0

Table A.2: Sales to large consumers	PJ	%
NGC	[]	[]
Enerco	[]	[]
Shell/Todd	[]	[]
ECNZ	[]	[]
Powerco	[]	[]
TransAlta	[]	[]
Nova Gas ⁸	[]	[]
Wanganui Gas	[]	[]
Pacific Energy	[]	[]
Contact ⁹	[]	[]
	47.7	100.0

⁷ In the current year Contact will supply Enerco with 8.3 PJ, replacing gas previously supplied by NGC.

⁸ Shell/Todd anticipate that in the current year it will supply Nova Gas with 2 to 3 PJ.

⁹ Contact will supply 6.3 PJ to NZ Dairy Group from 1 June 1999 for a new co-generation plant at Te Rapa and replacing 1.8 PJ currently supplied by NGC.

Table A.3: Sales to Resellers and Large Users	1997/98 All Sales		Excluding inter-company Sales		1998/99 Est Sales		Excluding inter-company Sales	
	PJ	%	PJ	%	PJ	%	PJ	%
NGC to:								
• NGC Utilities	[]		[]		[]		[]	
• Wanganui Gas	[]		[]		[]		[]	
• Powerco	[]		[]		[]		[]	
• Other Utilities								
• Large users								
NGC Utilities to:								
• Large users	[]		[]		[]		[]	
Wanganui Gas to:								
• Large users	[]		[]		[]		[]	
Total NGC	[]	[]	[]	[]	[]	[]	[]	[]
Powerco to:								
• Large Users	[]		[]		[]		[]	
• Resellers	[]		[]		[]		[]	
Total Powerco	[]	[]	[]	[]	[]	[]	[]	[]
Other Utilities to:								
• Large Users	[]		[]		[]		[]	
Contact to:								
• Powerco	[]		[]		[]		[]	
• Other Resellers	[]		[]		[]		[]	
Shell/Todd to:								
• Resellers	[]		[]		[]		[]	
• Kiwi	[]		[]		[]		[]	
Nova Gas to:								
• Large Users	[]		[]		[]		[]	
ECNZ to:								
• Large Users	[]		[]		[]		[]	
Total non-NGC/Powerco	[]	[]	[]	[]	[]	[]	[]	[]
Total	88.4		70.7		88.4		70.7	