

Commerce Commission

Decision No. 435

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

NATURAL GAS CORPORATION HOLDINGS LIMITED

and

AGL NZ ENERGY LIMITED

The Commission: M J Belgrave
P R Rebstock
D F Curtin

Summary of Application: Natural Gas Corporation Holdings Limited (NGC) has sought clearance to acquire the low pressure gas distribution system (excluding customer meters and regulator sets) in the Hutt Valley, Tawa and Porirua areas which is owned by AGL NZ Energy Limited.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give a clearance for the proposed acquisition.

Date of Determination: 8 June 2001

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CONTENTS

THE PROPOSAL	1
BACKGROUND.....	1
THE PARTIES	1
NGC.....	1
AGL.....	2
PROCEDURES	2
INVESTIGATION	3
GOVERNMENT REVIEW OF THE GAS SECTOR	3
MARKET DEFINITION	4
SEPARATE ELECTRICITY AND GAS PRODUCT MARKETS	5
GAS TRANSMISSION	5
GAS DISTRIBUTION	5
GAS RETAILING TO RESIDENTIAL CONSUMERS	6
GAS RETAILING TO INDUSTRIAL AND COMMERCIAL CONSUMERS.....	6
CONCLUSION ON MARKET DEFINITIONS	6
COMPETITION ANALYSIS	7
THE MARKET FOR THE RETAILING OF GAS TO RESIDENTIAL CONSUMERS IN HUTT/MANA	7
<i>Comparison of Competition in Vertically Integrated and non Vertically Integrated Networks</i>	7
<i>Experience of New Entrants</i>	8
<i>Potential Competition</i>	9
<i>Conditions of Entry</i>	9
<i>Access to Gas Network</i>	10
<i>Access to Competitive Information</i>	11
<i>Delays in Switching</i>	12
<i>Conclusion on Current Competition</i>	12
<i>Conclusion on the Competitive Implications of the Proposed Acquisition</i>	13
THE NORTH ISLAND MARKET FOR THE RETAILING OF GAS TO INDUSTRIAL AND COMMERCIAL CONSUMERS .	14
THE HUTT/MANA GAS DISTRIBUTION MARKET	14
THE NORTH ISLAND GAS TRANSMISSION MARKET	15
CONCLUSION	15
DETERMINATION ON NOTICE OF CLEARANCE	16

THE PROPOSAL

- 1 Pursuant to section 66(1) of the Commerce Act 1986 (the Act), NGC gave notice to the Commission dated 8 May 2001, seeking clearance for it or any of its wholly owned subsidiaries to acquire the low pressure gas distribution system (excluding customer meters and regulator sets) in the Hutt Valley, Tawa and Porirua areas, which is owned by AGL NZ Energy Limited.

Background

- 2 The current notice refers to an application made by NGC to acquire a 75.8% shareholding in TransAlta New Zealand Limited (TransAlta) which included among its activities the retailing of gas in Hutt Valley, Tawa and Porirua areas (Hutt/Mana). The Commission gave a clearance to that application in Decision 387¹. During the Commission's consideration of that proposed acquisition, NGC amended its application to include a Deed by NGC and AGL whereby, in essence, those parties undertook that AGL would dispose of its gas distribution system in Hutt/Mana by 1 October 2001. The undertaking required that the divestment be made to a person independent of NGC and AGL, unless the sale to NGC or an associated company did not breach the Commerce Act.
- 3 In effect NGC, in now seeking clearance, is asking the Commission to determine that the continued ownership of the network within the AGL/NGC group does not result in the acquisition or strengthening of dominance in a market.
- 4 The Commission notes that the undertaking in Decision 387 was unusual in that it provided for the possibility of a divestment undertaking being met by the sale to an associated person. The Commission emphasises that it accepted such an undertaking only because of the particular features associated with that application and it does not set a precedent for future undertakings. It is only in very exceptional circumstances that it will accept future divestment undertakings which do not require that the divestment be made to an independent party.

THE PARTIES

NGC

- 5 NGC is a listed company, the largest shareholder of which is the Australian Gas Light Company (AGL) with a 66% interest. The Hutt Mana Energy Trust and its associated Hutt Mana Charitable Trust together hold a 10.2% interest in NGC, and the remaining 23.8% is held by institutions and the public.
- 6 During 2000, NGC purchased TransAlta New Zealand Limited, which is now 100% owned by NGC. TransAlta, which has since been renamed On energy Limited, is an

¹ Decision 387, *Natural Gas Corporation Holdings Limited and TransAlta New Zealand Limited*, 17 March 2000.

energy company with operations principally in electricity generation and wholesaling, electricity retailing and gas retailing.

- 7 On energy is the incumbent electricity retailer in the greater Wellington area, Christchurch and parts of Auckland. It is the incumbent retailer of gas in the Hutt Valley and Porirua areas, referred to in this decision as Hutt/Mana.
- 8 NGC's operating subsidiary Natural Gas Corporation of New Zealand Limited undertakes the business of the acquisition, transmission and marketing of gas throughout the North Island. NGC, through this subsidiary is a distributor and retailer of gas in Northland, Waikato, Bay of Plenty, Taupo, Gisborne and Kapiti, and a retailer of gas in Taranaki. NGC has a 25.1% interest in the Wanganui gas distributor and retailer, Wanganui Gas Limited. NGC also owns 50% of the Kapuni Energy joint venture, which undertakes electricity and steam generation at the Kapuni gas treatment plant site.

AGL

- 9 The 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 gas to residential, commercial and industrial consumers. In New Zealand, AGL has a management contract to manage the distribution and retail businesses of NGC. In 1999, a subsidiary of AGL, AGL NZ Energy Limited (AGLNZE) purchased TransAlta's gas distribution network. AGL has a 20.5% shareholding in TrustPower Limited, an electricity generating and retailing company.

PROCEDURES

- 10 The application was registered by the Commission on 8 May 2001. Section 66(3) of the Commerce Act requires that the Commission, within 10 working days after the date of registration of the application, or such longer period agreed by the Commission and the applicant, gives, or declines to give, a clearance for the acquisition. The tenth working day after the registration of the application was 22 May 2001. The Commission and NGC agreed to an extension of the period, with the Commission's determination being required by 8 June 2001.
- 11 NGC advised the Commission that it did not seek a confidentiality order for the fact of the application, but that it did require confidentiality for some specific information contained in the application. The Commission, in accordance with section 100 of the Commerce Act, made a confidentiality order on 10 May 2001 prohibiting the publication or communication of that information.
- 12 The Commission's determination is based on an investigation conducted by its staff and the information subsequently provided by staff to the Commission.

INVESTIGATION

- 13 In the course of their investigation of the proposed acquisition, Commission staff have discussed the application with, and received submissions from, a number of parties including:
- Contact Energy Limited (Contact);
 - Todd Energy Limited (Todd Energy)/Fresh Start;
 - UnitedNetworks Limited;
 - E-Gas 2000 Limited; and
 - Wanganui Gas Limited.
- 14 In addition staff have sought and received comment and further information from NGC. Also the Commission has taken into account information gathered during the course of its consideration of the NGC/TransAlta application, to the extent it remains relevant.

Government Review of the Gas Sector

- 15 The Minister of Energy announced on 15 March 2001 that the Government was to undertake a review of the New Zealand gas sector. The Minister stated in part:

“Having reviewed the electricity industry and introduced the Power Package reforms, it is now time to put the gas industry under scrutiny.

The Government’s energy policy objective is to ensure that energy is delivered in an efficient, fair, reliable and sustainable manner to existing and potential users. This includes gas as well as electricity.

Labour’s pre-election energy policy noted that the gas market may not have developed enough to ensure the most efficient use of this non-renewable resource.

The key issues for the review include the overall efficiency of the gas sector and the current regulatory environment. Factors affecting consumer choice, such as pricing and fixed charges, will be examined. The review will also cover issues relating to gas take-or-pay contracts – including their effect on the efficiency of gas use, whether they result in gas-fired electricity generation displacing hydro, causing unnecessary water spill.”

- 16 On 27 April, the Minister announced that an independent consultant had been commissioned to assist the review, and that after the consultant has reported, he would release a discussion paper seeking submissions from the public and interested parties. The Minister said:

“Following this consultation, policy options are expected to be considered by the Government later in 2001.”

- 17 In its consideration of the application before it, the Commission has noted the Government’s review of the gas sector. However the outcome of the review is not known at this time and as a consequence it has not affected materially the Commission’s analysis of the application.

MARKET DEFINITION

18 Section 3(1A) of the Commerce Act provides that:

“... ‘market’ is a reference to 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.”

In considering a proposed business acquisition in terms of section 66 of the Commerce Act, market definition is an important step towards making an assessment of the competitive impact of the acquisition.

19 The Commission’s *Business Acquisitions Guidelines* specify a relevant market to be:

“...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 the transactions take place; and, where appropriate,
 the time period;
 within which a 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”.^(p14)

20 In determining relevant markets, the *Business Acquisitions Guidelines* state that:

“...the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of a minimum of one year.”^(p15)

21 The *Business Acquisitions Guidelines* draw a clear distinction between the processes of defining a relevant market and of assessing dominance:

“It is important to distinguish the process of defining a relevant market from that of assessing whether a business acquisition will lead to the acquisition or strengthening of a dominant position. This first step is a hypothetical exercise which assumes the creation of a total monopoly and estimates buyer reaction to a given level of price rise. The *ssnip* approach is relevant to that process. This does not presuppose or require that such a *ssnip* would result from the actual acquisition which is then to be evaluated in terms of the relevant markets identified through that process”.^(p15)

22 To identify the markets relevant to the application, it is necessary to consider the business activities undertaken by the merging firms and to assess whether, post-acquisition, dominance would, or would be likely to, result or be strengthened.

23 The application for which clearance is sought is the acquisition of the Hutt/Mana low pressure gas distribution system. Accordingly it is the gas business activities which are relevant to the assessment of the competitive impact of the acquisition.

24 NGC is a distributor and incumbent retailer of gas in Northland, Waikato, Bay of Plenty, Taupo, Gisborne and Kapiti, and incumbent retailer of gas in Taranaki and in Hutt/Mana. NGC also owns the North Island gas transmission system.

- 25 AGL, through AGLNZE, is the gas distributor in Hutt/Mana.

Separate Electricity and Gas Product Markets

- 26 The Commission has previously adopted discrete electricity and gas product markets when assessing business acquisitions in the energy sector. The Commission remains of the view at this time that there is insufficient substitutability between electricity and gas to place the two energy forms in the one market. As noted in Decision 387, the Commission will continue to monitor the situation closely to determine whether there is a case for changing its product market definition in the future.

Gas Transmission

- 27 Gas transmission is undertaken by way of high pressure gas pipeline systems: South, North, Bay of Plenty, Morrinsville and Oaonui/Huntly. The latter pipeline is operated by NGC on behalf of the Maui Joint Venture. The other pipelines are all owned and operated by NGC.
- 28 Consistent with past practice, the Commission has used a North Island market for its consideration of the impact of the proposal on the transmission of gas.

Gas Distribution

- 29 NGC owns and operates gas distribution networks in Northland, Waikato, Bay of Plenty, Taupo, Gisborne and Kapiti. Its parent, AGL, owns the Hutt/Mana network. This network is operated by NGC while On energy is the principal retailer using that network. As AGL has no gas distribution business outside Hutt/Mana, the only gas distribution market affected by the proposed acquisition is that encompassing Hutt/Mana.
- 30 Until the time of Decision 333 (10 December 1998), the Commission considered issues affecting the distribution of gas using “delivered gas” markets. Delivered gas encompassed both the gas and the delivery of that gas. In Decision 333 the Commission recognised that divestments by some gas utilities resulting in the ownership separation of gas distribution and retail businesses, and also the potential emergence of new retailers, meant that consumers would no longer necessarily receive both their distribution services and gas from a single entity. The Commission therefore adopted separate markets for the supply of gas and the distribution of that gas. The Commission considers that separate markets remain appropriate.
- 31 Gas distribution networks have historically been viewed as natural monopolies. The sunk cost associated with existing pipelines and the scale economies derived from the operation of gas distribution networks means that the duplication of pipelines has generally not been economically viable. However in limited areas competition for distribution to large customers has developed in recent years. This has come about principally through by-pass and through limited networks constructed and operated by Nova Gas Ltd (Nova), a subsidiary of Todd Energy.

- 32 Nova has a more extensive gas network in Hutt/Mana than elsewhere. It now supplies major gas consumers in the area by way of its own pipes that run alongside those of AGL. However its reach covers only a very small proportion of all gas consumers in the area.
- 33 The Commission considers that the relevant market to consider the gas distribution issues raised by the current proposal is the market for the distribution of gas in the geographic region defined by AGL's distribution network; that is Hutt/Mana.

Gas Retailing to Residential Consumers

- 34 For residential consumers the Commission has concluded in the past (including in NGC/TransAlta Decision 387) that gas retailing falls within localised geographic markets, each corresponding with the geographic boundaries of the relevant distribution network.
- 35 In its application, NGC advised that it "is willing to proceed on the basis of the relevant markets as defined by the Commerce Commission in Decision 387". NGC, however, raised the issue of the appropriateness of a wider geographic market.

"In this application NGC submits that competition in the gas retailing market has further developed since Decision 387, as evidenced in the Hutt/Mana region, and that a national gas retailing market may now be justified. However, it considers that such a market definition is not necessary in the context of the present application, although it wishes to reserve the opportunity to make further submissions on this point if necessary."

- 36 While the Commission recognises that competition for residential customers has increased in some areas since Decision 387, usually as part of dual fuel offers with electricity, it notes that there are still a number of areas with no significant competition and no indication that it will develop in the near future.
- 37 The Commission does not consider it necessary at this time to reach a view on whether gas retailing to residential consumers is now part of a North Island gas retailing market. Rather it has adopted the conservative position and used a discrete Hutt/Mana market for the retailing of gas to residential consumers.

Gas Retailing to Industrial and Commercial Consumers

- 38 For the reasons given in Decision 387, the Commission believes that it is appropriate to define a discrete gas retail market for industrial and commercial consumers. This market is North Island in scope.

Conclusion on Market Definitions

- 39 The Commission concludes that the relevant markets for the analysis of the proposed acquisition are:
- the market for the retailing of gas to residential consumers in Hutt/Mana;
 - the market for the retailing of gas to industrial and commercial consumers in the North Island;
 - the market for the distribution of gas in Hutt/Mana; and
 - the market for the transmission of gas in the North Island.

COMPETITION ANALYSIS

The Market for the Retailing of Gas to Residential Consumers in Hutt/Mana

- 40 This market encompasses the supply of gas to 26,500 residential gas consumers in the Hutt/Mana area. These consumers are all connected to the AGL network. The Nova network in the region does not currently distribute gas to residential customers, nor is it available to independent retailers at present.
- 41 At the time of its NGC/TransAlta decision in March last year, the Commission noted that TransAlta was the only supplier of gas to residential customers. As was stated in the Decision:
- “While the Commission believes that new entry in the market is possible, it is not yet satisfied that this entry is sufficiently likely, or that it will be of sufficient scale, or sufficiently timely or sustainable to prevent TransAlta from being able to exercise a dominant influence in the market.”
- 42 As a result of the NGC/TransAlta acquisition, NGC (On energy) is now the incumbent retailer to Hutt/Mana residential consumers. NGC has advised that since November last year it has lost a significant number of residential customers to competing retailers. As at 15 May 2001 the number of residential consumers who had switched from NGC to another retailer amounted to [], or approximately [] of all residential gas consumers in the market. Almost all of these have switched to FreshStart, a subsidiary of Todd Energy.
- 43 Todd Energy has informed the Commission that FreshStart now has approximately [] residential customers in Hutt/Mana which is broadly in line with the information provided by NGC. FreshStart entered the retail market in November 2000.
- 44 The only other retailer in the residential market is E-Gas 2000 Limited, a small new retailer which focuses predominantly on small commercial customers mainly in Auckland, but in Hutt/Mana also currently has a very small number [] of residential customers. E-Gas is partly owned by Nova Gas and has advised that [].

Comparison of Competition in Vertically Integrated and non Vertically Integrated Networks

- 45 NGC’s retail business in Hutt/Mana is currently effectively vertically integrated with the network business of AGL. Some concern has been expressed to the Commission that the continuation of this vertical integration (as a result of the proposed acquisition) in itself raises such competition concerns that the application should be declined.
- 46 In its consideration of this view the Commission has compared the operation of access regimes on vertically integrated and non vertically integrated networks. The information below is sourced primarily from UnitedNetworks Ltd and NGC. In all UnitedNetworks’ areas, Contact is the incumbent retailer.

- 47 The table below provides some indication of the current level of competition on networks which are vertically integrated and those which are not.

Network	Owner	Vertically Integrated?	Total number of customers	Number of Residential Customers with Non-incumbent Retailers
Northland	NGC	Yes	[]	[]
Waikato	NGC	Yes		
Kapiti	NGC	Yes		
Bay of Plenty	NGC	Yes		
Auckland	United	No	[]	[]
Manawatu	United	No	[]	[]
Hawkes Bay	United	No	[]	[]
Wellington	United	No	[]	[]
Taranaki	Powerco	No	[]	[] approx
Hutt/Mana	AGL	Yes	[]	[]
Wanganui	Wanganui Gas	Yes	[]	[]

- 48 All network owners have network service agreements available for gas retailers, and these agreements are applicable for retailing to both industrial and commercial consumers and to residential consumers.
- 49 On the Wellington network, new entrant retailers have an []% share of residential customers. Of the new entrants, Fresh Start and On energy have the largest number of customers, with []% and []% respectively.
- 50 The percentage of the market with new entrants in Wellington is comparable with that in Hutt/Mana and is considerably higher than in other areas. The principal other areas where new entrants have captured market shares are Wanganui (vertically integrated) []%, Manawatu (not vertically integrated) []%, and Taranaki (not vertically integrated) []%. Thus the areas where significant new entry has occurred are not limited to those areas where there is no vertical integration.
- 51 The Commission considers that experience to date indicates that vertical integration does not in itself prevent competition from developing in the residential retail market.

Experience of New Entrants

- 52 FreshStart entered the market late last year. It has been very successful in capturing market share in the short period it has been in the market. Over this period its delivered gas price has been around 11% below that of the incumbent, although it has now announced that from 21 June its prices will be increased to 28 cents a day and

5.8c per kWh. This compares with On energy's current prices of 28.13 cents a day and 5.84 cents/kWh.

- 53 FreshStart accepts as residential gas customers only those residential consumers who also obtain electricity from FreshStart. FreshStart considers that []].
- 54 The Commission sought comment from Todd Energy on matters affecting the ability of its subsidiary FreshStart to compete with NGC/On energy in the Hutt/Mana market. In brief Todd Energy's principal concerns as expressed to the Commission related to the ability of NGC to delay switching customers, to use information competitors have provided to its distribution and transmission arms to assist its retail arm, and to cross-subsidise its retail operation from its network business. These matters are discussed further below.
- 55 E-Gas's experience in the market is very limited at this time. It is supplying [] residential customers. It has informed the Commission that nobody has been obstructive to its activities in Hutt/Mana or elsewhere. It considers that switching in Hutt/Mana had been handled by NGC quite efficiently. The Commission recognises that E-Gas is only a small player at this stage and it is unlikely that it would be seen by NGC as a major competitive threat in the short to medium term.

Potential Competition

- 56 Contact is the incumbent retailer of gas in Wellington, Auckland, Manawatu, Horowhenua and Hawkes Bay. It also retails electricity, as does FreshStart. At the time of NGC's application to acquire TransAlta, Contact []].
- 57 Contact has advised that its previous comments are still applicable. It has not entered the Hutt/Mana residential retail market, but it has not identified any significant costs of entry and it does not consider that there are any structural barriers to entry into the market. []]
- 58 Contact has indicated that []]. It has the infrastructure in place and would be able to offer both gas and electricity to consumers in the same way as On energy and FreshStart.

Conditions of Entry

- 59 The Commission in Decision 387 discussed the conditions which would face a potential entrant to the Hutt/Mana market for retailing gas to residential consumers. The Commission's conclusion was that new entrants would not face high barriers to entry from costs of access to materials, technology or capital.

- 60 The Commission also concluded at that time that TransAlta was likely to have an advantage over new entrants as it traded under a name which was well established amongst gas consumers in the Hutt/Mana area. Since that time, NGC has discontinued the use of the TransAlta brand name, and now retails under the new name On energy. Accordingly the Commission now considers that in this instance the right to use the long established brand name does not give the incumbent an advantage over new entrants.
- 61 The Commission remains of the view that access to materials, capital and technology do not constitute a significant entry barrier. The matters which have been the subject of some debate is the ability of new retailers to access the distribution networks on appropriate terms and conditions when the network is owned by the incumbent retailer, the ability of the incumbent retailer to obtain access to competitors' sales information, and the ability of the incumbent to delay customer switching.
- 62 These matters are considered separately below.

Access to Gas Network

- 63 NGC has stated in its application:

“NGC submits that the vertical integration that may result from the proposed acquisition raises no competition concerns in the distribution market due to {by-pass and the network constructed and operated by Nova; the information requirements imposed on distribution network owners by the Gas (Information Disclosure) Regulations 1994, and the open access regime operated by AGL and to which NGC is also committed; and the inter-fuel constraint posed by electricity and, to a lesser extent, LPG.}

The information requirements and the open access regime regulate operation of the distribution networks. The existence of the deemed profiling and reconciliation agreements and open non-discriminatory access regimes (including reconciliation procedures and posted prices) means a mechanism enabling retail consumers to switch retailers has been established. These provisions have remained operative since the Commission delivered Decision 387, including in the Hutt/Mana markets. The draft industry Switching Protocol referred to in the TANZ clearance application has been finalised (as part of the Reconciliation Code dated 1 July 2000) and there is evidence of its effective operation in the context of the Hutt/Mana residential gas market.

The non-discriminatory open access regime for the AGL Network is set out in the following documents:

- The New Zealand Gas Pipeline Access Code of July 1998, a voluntary code of practice designed to facilitate the development of a competitive market for gas retailing.
- The AGLNZE Information Memorandum of March 1999, which describes the pricing, technical and procedural details for the transport of gas on the network.
- The Network Services Agreement between AGLNZE and users of the AGL Network, which governs the conduct, rights and obligations of AGLNZE and a network user. In addition, there are Transmission Services Agreements, Distribution Services Agreements, and Allocation Agreements which define the commercial relationship between persons wishing to use the network and the owners of the network, and regulate the transfer of gas at receipt points.

- The Reconciliation Code of 1 July 2000, including the Switching Protocol, which regulates and smooths the switching of gas consumers from one to another without significant costs to the consumer. The Reconciliation Code also provides for the allocation and reconciliation of gas quantities between users at receipt points into a transmission system or distribution network at which possession, control or ownership of gas passes from one person to another.”

64 The Commission notes that if a network owner unreasonably denies a retailer access to its network, it is very likely to be in breach of Part II of the Commerce Act, and also that such a breach is likely to be transparent. To date, at least, the Commission has received no complaints of denial of access by gas network owners, whether vertically integrated or not. Nor has Todd Energy suggested that there has been outright denial in Hutt/Mana. Rather its concerns are that the network owner can use more subtle means of disadvantaging new retail competitors. In particular it has suggested that as a vertically integrated network, NGC is able to offer low retail prices because it subsidises its retail activity from its distribution business where it does not face competition.

65 While the Commission accepts that vertically integrated businesses may choose to cross-subsidise one business from another, this does not appear to have been the basis for the current network and gas prices in Hutt/Mana. Network prices have not increased since AGL acquired the network in April 1999 and are broadly in line with those charged by other networks. Retail gas prices in Hutt/Mana have not changed since NGC acquired TransAlta in March 2000. NGC appears to be seriously constrained in its retail pricing by the successful entry of FreshStart which has been offering lower retail prices.

66 Anti-competitive cross-subsidisation would be likely to breach the Commerce Act. The Commission is of the view that this cannot be demonstrated at present in respect of NGC’s Hutt/Mana pricing.

Access to Competitive Information

67 The suggestion that NGC’s retail operation would be able to obtain commercially sensitive information about competitors from its network business was put to NGC. NGC responded:

“{The suggestion} is rejected. Significant provisions have been put in place by NGC and AGL in the Information Memorandum and Confidentiality Protocol to ensure the protection of confidential information on activities of other retailers using the AGL Network. These documents include procedures and remedies in the event of alleged breaches of confidentiality, which can be invoked by retailers. NGC has received no such allegations from FreshStart or any other retailer.”

68 The Commission has also not received any formal complaint in this respect. Nevertheless it recognises that breaches of confidentiality are not easily proven one way or the other, and it may be that the mere perception that Chinese walls may not be insurmountable is sufficient to deter some new entry. It notes however that confidentiality concerns are likely to be more of an issue in respect of competition for commercial and industrial customers than they are for residential customers.

Delays in Switching

- 69 The Commission has given careful consideration to the question of how easy it is for customers to switch from the incumbent retailer to new entrants. As in the electricity sector, there have been claims in the gas sector that the incumbent has taken excessive time to arrange switching, and that this has hindered the development of competition.
- 70 From the information provided to it, the Commission has concluded that there have been periods when the time taken to switch residential gas customers from NGC to FreshStart has been excessive. NGC has pointed out that it was faced with requests for switching very large numbers in late 2000 and early 2001 when its systems for handling this function were not fully developed. While the Commission accepts that the level of requests for switching at that time would have put a strain on the resources of most companies, there was a subsequent 6 week period when NGC appears to have been somewhat dilatory in carrying out this function.
- 71 NGC has advised the Commission that it has improved its performance substantially in the past month or so and that a new automated switching tool it has purchased will ensure that this improvement is maintained. On the face of it the speed with which switching has occurred in May appears reasonable.
- 72 The Commission considers that this speed does have an impact on new entry. Undue delays do impose a cost on the new entrant. Further, until consumers in general have confidence that the process does not cause them inconvenience, they may be reluctant to sign with a new entrant, even if its prices are less than the incumbent.

Conclusion on Current Competition

- 73 FreshStart has been very successful in gaining market share from NGC in a short time, notwithstanding that its offer to supply gas to residential consumers is linked to its electricity supply to those customers. The loss by NGC of [] of its gas customers to FreshStart appears to have had an effective competitive influence on NGC in the market. For instance in the period it has owned the retail business it has not increased its price of gas.
- 74 The parent of FreshStart is Todd Energy. Todd Energy is part of the Todd group of companies which has substantial investments in the New Zealand energy sector. It has been competing vigorously for retail electricity and gas customers, principally in the lower North Island, and an important selling point has been its ability to sell gas and electricity together. The Commission considers that FreshStart has access to the resources and expertise necessary to provide a sustainable retailing operation in Hutt/Mana.
- 75 Todd Energy has expressed strong concerns to the Commission about the ability of NGC to use its market power as incumbent retailer and also distributor of gas in Hutt/Mana to disadvantage new entrants. It has suggested that NGC has delayed the switching of customers, subsidised the retail business from its monopoly distribution business, and used confidential information provided to its distribution business for the advantage of its retail business.

- 76 The Commission has given careful consideration to these matters. It considers that there have been some unreasonable delays in switching in the past, although more recently NGC has improved its performance. It also accepts that there are some advantages available to NGC from vertical integration. However the Commission considers that notwithstanding the possible disadvantages faced by a new entrant retailer such as FreshStart, the market is now competitive and NGC is not in a dominant position in the retail market.

Conclusion on the Competitive Implications of the Proposed Acquisition

- 77 The proposed acquisition would result in continued vertical integration between the incumbent retailer and the distributor. The concern of some market participants is that NGC could use its dominant position as distributor to obtain market power in the retail market.
- 78 The Commission accepts that NGC achieves some efficiencies from vertical integration. For instance it may have lower transaction costs than would otherwise be the case. In itself, this does not raise competition concerns. Competition in the retail market could be seriously harmed if NGC as the network owner discriminated in favour of On energy and against other retailers. Section 36 of the Act prohibits this behaviour. Further it is likely that significant anti-competitive discrimination by any network owner could not be hidden, given the disclosure requirements of the Information Disclosure Regulations, the Reconciliation Code and other agreements and contracts in place.
- 79 The Commission has not received complaints in the past year about anti-competitive discrimination by network owners. Also the fact that a significant number of retailers have been using the networks of their vertically integrated competitors to supply commercial and industrial customers indicates that vertical integration does not necessarily cause undue harm to competition.
- 80 None of the parties spoken to by the Commission has suggested that there are insurmountable barriers to entry into the residential retail market.
- 81 FreshStart's success in the retail market since November last year has placed a strong competitive pressure on NGC. NGC has not increased its prices since it acquired TransAlta early last year, even though [
-]
- FreshStart's price for an average domestic consumer in Hutt/Mana is around 11% less than On energy's price (although the effect of the recently announced price increase by FreshStart will be to reduce its price advantage to less than 1%.)
- 82 The Commission recognises that FreshStart will accept as residential gas consumers only those who also agree to switch their electricity supply to FreshStart. In these circumstances those consumers who are contractually committed to another electricity supplier, or who have a strong preference for a particular electricity retailer, may be reluctant to switch to FreshStart even if NGC increases its gas prices significantly.

- 83 On the other hand, FreshStart's electricity prices appear to be among the lowest of the seven electricity retailers in Hutt/Mana and many consumers appear to welcome the advantages that come from dealing with only one energy supplier. The Commission is confident that there are sufficient consumers who would have the ability to switch from NGC to FreshStart in the event of a significant gas price increase by the former to place a strong competitive pressure on NGC post acquisition.
- 84 The Commission is satisfied therefore that the proposed acquisition would not result, or be likely to result, in the acquisition or strengthening of dominance in the market for the retailing of gas to residential consumers in Hutt/Mana.

The North Island Market for the Retailing of Gas to Industrial and Commercial Consumers

- 85 Competitors in this market include NGC, Contact, Todd Energy and Nova. As discussed in Decision 387, the Commission does not consider that there are major barriers to new entry or to expansion by existing players.
- 86 The proposed acquisition would result in vertical integration between the distribution network owner and the incumbent retailer in Hutt/Mana. The Commission does not consider that would result in the acquisition or strengthening of a dominant position in this market.

The Hutt/Mana Gas Distribution Market

- 87 The Hutt/Mana gas distribution market corresponds in area with the gas distribution network owned by AGL.
- 88 Gas distribution networks have been viewed by the Commission as natural monopolies, although it has recognised that there can be some competition arising from bypass. Bypass has occurred to an important extent in Hutt/Mana primarily as a result of the activity of Nova which has pipelines in the region in Porirua, Tawa and along the Petone foreshore supplying principally light industrial customers. []
- 89 Bypass opportunities tend to be limited to areas where there is a concentration of medium to large consumers who are close to the transmission pipeline or to an existing bypass network. Incumbent network owners usually take account of the threat of bypass when setting their network charges. However the new entrant, or its customers, may also have strategic reasons for investing in bypass pipelines even when the incumbent reduces its charges to match possible bypass charges. These reasons may include their wish to obtain greater bargaining power when negotiating future network charges with the incumbent. The threat of bypass is likely to have a greater impact on the incumbent network company if the negotiating party has a history of laying bypass pipelines.

- 90 Because of the limited scope of Nova’s network, AGL faces no competitive threat at present for the distribution to residential consumers in Hutt/Mana. The Commission considers that AGL is currently in a dominant position in the market, notwithstanding competition at the edges from Nova, and some constraint from potential bypass.
- 91 The proposed acquisition involves no aggregation in the Hutt/Mana gas distribution market, nor does it have a direct impact on bypass potential.
- 92 The Commission is satisfied that the proposed acquisition would not be likely to result in NGC strengthening its dominant position in the Hutt/Mana gas distribution market.

The North Island Gas Transmission Market

- 93 NGC is the owner and operator of all transmission pipelines, apart from the Maui pipeline running between Oaonui and Huntly, which is owned by the Maui joint venture partners and operated by NGC. The Commission considers that NGC remains in a dominant position in this market, notwithstanding that the threat of bypass can place some constraint on its pricing behaviour in special circumstances.
- 94 NGC has stated that it operates a fully open access transmission system offering non-discriminatory service to all customers in compliance with the New Zealand Pipeline Access Code and its Information Memorandum.
- 95 Other constraints placed on NGC in this market may come from information disclosure requirements, the threat of regulation, and the countervailing power of major customers. The current proposal would not affect information disclosure or the threat of regulation. In addition, the Commission considers that any constraint on NGC arising from the countervailing power of major customers would not be affected by the proposal. The ownership of the Hutt/Mana network has no effect on the ability of major customers such as Contact to constrain NGC in the transmission market.
- 96 The Commission concludes 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 gas in the North Island.

CONCLUSION

- 97 The Commission has considered the impact of the proposal in the four relevant markets:
- the market for the retailing of gas to residential consumers in Hutt/Mana;
 - the North Island market for the retailing of gas to industrial and commercial consumers;
 - the gas distribution market in Hutt/Mana; and
 - the North Island gas transmission market.

- 98 Having regard to the factors set out in section 3(9) of the Commerce Act and all the other relevant factors, the Commission concludes that the proposal would not result, or would not be likely to result, in NGC or any other person acquiring or strengthening a dominant position in a market.

DETERMINATION ON NOTICE OF CLEARANCE

- 99 Pursuant to section 66(3) of the Commerce Act 1986, the Commission gives clearance for the acquisition by Natural Gas Corporation Holdings Limited, and/or any of its wholly-owned subsidiaries, of the low pressure gas distribution systems (excluding customer meters and regulator sets) in the Hutt Valley, Tawa and Porirua areas, which is owned by AGL NZ Energy Limited.

Dated this day of June 2001

M J Belgrave
Chair