



COMMERCE COMMISSION

Decision No. 446

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

DUNEDIN ELECTRICITY LIMITED

and

OTAGO POWER LIMITED

- The Commission:** PR Rebstock
DF Curtin
- Summary of Application:** The acquisition by Dunedin Electricity Limited of up to 100% of the assets or shares of Otago Power Limited, including the assets and shares of its wholly owned subsidiary Otago Power Services Limited.
- 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:** 6 December 2001

CONTENTS

THE PROPOSAL	1
THE PROCEDURES.....	1
THE PARTIES	1
Dunedin Electricity Limited	1
Otago Power Limited	1
Other Relevant Parties	1
Delta Utility Services Limited	1
Otago Power Services Limited	2
MARKET DEFINITION.....	2
Provision of Electricity Lines Services	3
Provision of Electricity Lines Maintenance and Contracting Services.....	3
COMPETITION ANALYSIS.....	4
Substantially Lessening Competition.....	4
Provision of Electricity Lines Services	5
Electricity Lines Maintenance and Contracting Services.....	6
Overall Conclusion.....	6
Determination on Notice of Clearance	7

THE PROPOSAL

1. On 21 November 2001 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 (the Act), from Dunedin Electricity Limited (DEL and the Applicant) to purchase all of the assets or shares of Otago Power Limited (OPL) including the assets and shares of its wholly owned subsidiary Otago Power Services Limited (OPSL).

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. Accordingly, a decision on the application was required by Friday 7 December 2001.
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

THE PARTIES

Dunedin Electricity Limited

5. DEL is a wholly owned subsidiary of Dunedin City Holdings Limited, the holding company for various trading enterprises of the Dunedin City Council. DEL is a deemed energy company for the purposes of certain provisions of the Energy Companies Act 1992. DEL owns the electricity distribution networks for the metropolitan Dunedin and the Central Otago areas.

Otago Power Limited

6. OPL owns an electricity distribution network that covers South Otago, coastal Otago (excluding metropolitan Dunedin), the Strath Taieri and the Maniototo.

OTHER RELEVANT PARTIES

Delta Utility Services Limited

7. DELTA Utility Services Limited (DUSL) is a wholly owned subsidiary of DEL and provides lines maintenance and contracting services to Dunedin Electricity Limited and other parties.

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.

Otago Power Services Limited

8. OPSL is a wholly owned subsidiary of OPL that supplies lines maintenance and contracting services to OPL and other parties.

MARKET DEFINITION

9. 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.

10. 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.
11. 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.
12. The Commission, in assessing mergers of power companies, has previously considered a number of related markets. Generally, the Commission concluded that there were:
- a national electricity generation and wholesaling market;
 - a national electricity network contracting services market;
 - a national market for the ownership and operation of new distribution networks;
 - distinct geographic markets corresponding to the distribution networks of the merging parties for electricity distribution to small consumers; and
 - a national market for the retailing of electricity to medium and large consumers.
13. In the High Court judgment in *Power New Zealand Ltd v Mercury Energy Ltd* [1996] (“*PNZ v Mercury*”) 1 NZLR 686, subsequently upheld in February 1997 by the Court of Appeal, the court found at p 709:

...that there should be separate product markets in distribution; in supply of delivered electricity to small customers; and in retailing to medium and large customers. There are also separate product markets for electricity wholesaling; for transmission; and for construction of new networks. The ownership and operation of new networks, once formed, should be treated as forming part of the relevant distribution market.

As to geographic scope, the distribution markets and the small customer markets are local/regional in scope. The remainder are national in scope.

Provision of Electricity Lines Services

14. As the Electricity Industry Reform Act 1998 required the separation of power companies' lines businesses and supply businesses (electricity retailing and generation), the Commission proposes to adopt the following market definitions in this instance:
- The geographic markets for the provision of electricity lines services to electricity retailers.
15. The proposed acquisition relates to three discrete regions for the provision of electricity lines services to electricity retailers:
- Metropolitan Dunedin ("Dunedin" - marked 26a in Appendix 1);
 - Central Otago area ("Central Otago" - marked 26 in Appendix 1); and
 - South Otago, coastal Otago (excluding metropolitan Dunedin), the Strath Taieri and the Maniototo ("South Otago" – marked 27 in Appendix 1).
16. The Commission concludes that the relevant lines services markets are:
- The Dunedin market for the provision of electricity lines services to electricity retailers;
 - The Central Otago market for the provision of electricity lines services to electricity retailers; and
 - The South Otago market for the provision of electricity lines services to electricity retailers.

Provision of Electricity Lines Maintenance and Contracting Services

17. The subsidiaries of the acquirer and the target company, DUSL and OPSL, both provide lines maintenance and contracting services to their respective parent companies, as well as to other lines companies.
18. During its investigation, the Commission established that providers of such services are willing to travel throughout the South Island but are unwilling to travel to the North Island to secure work. Market participants stated that contracts in the North Island were uneconomical due to the cost of travel between the South and the North Island.
19. The Commission therefore concludes that, in this instance, the relevant lines maintenance and contracting market is:
- The South Island market for the provision of electricity lines maintenance and contracting services.

COMPETITION ANALYSIS

Substantially Lessening Competition

20. 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.

21. 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.²

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.³

22. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.⁴

23. 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.⁵

24. 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:

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).

25. 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

² *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).

³ *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.

⁴ For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

⁵ 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.

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.

26. 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.

Provision of Electricity Lines Services

27. DEL and OPL are natural monopolists in their respective geographic areas for the business of the provision of electricity lines services.
28. The acquisition by DEL of OPL will result in the expansion of DEL's monopoly over a larger geographical area.
29. The competitive effect of the acquisition by one lines company of another was further examined by the Court of Appeal in *Power New Zealand Limited v Mercury Energy Limited* [1997] ("*PNZ v Mercury CA*") 2 NZLR 669. In *PNZ v Mercury CA* the competition analysis was under the previous threshold of dominance. It was held that the transfer of Power New Zealand's monopoly to Mercury and the consequent expansion of Mercury's monopoly over a larger geographical area did not alter the character of its existing market dominance.
30. The Court held that section 48 (now repealed), which allowed for the bare transfer of a dominant position, applied to the acquisition. The Court noted that the purpose of section 48 was to allow a technical acquisition of dominance when it was in effect only a bare transfer. This was because "although a new owner acquired a dominant position there would be no effect on competition, however, as it would involve merely the substitution of one party for another as being in the dominant position". Of most relevance to the present application is the finding of the Court that there would be "no effect on competition".
31. Section 48 was repealed when the threshold for examination of mergers and acquisitions changed to one of substantially lessening competition. Now there is no need for a section 48 type provision. The focus is now on the degree of change in competition in the market as a result of the acquisition. Formerly the focus was on the status of the merged entity in the market – and whether that entity breached the prohibition of attaining a dominant position. A bare transfer of dominance therefore needed statutory exemption. Under the current SLC test, the same result arises because a bare transfer has no effect on competition.
32. The analysis under Section 48 in *PNZ v Mercury CA* remains relevant. A bare transfer of monopoly power has no effect on competition. It follows that the Commission can be

satisfied that the proposed acquisition by DEL of OPL will not have the effect of substantially lessening competition.

33. A possible issue arises with respect to the removal of potential cross-border competition between OPL and DEL. There is a potential for some limited competition on the geographic fringe of the markets. However, it is to be noted that the High Court in *PNZ v Mercury* was extremely sceptical of the degree of cross-border competition that was likely to occur in reality.
34. In the present case the geographic borders of the two lines companies do not intersect with significant population bases. The Commission concludes that there is minimal cross-border competition and the acquisition will have no, or a *de minimis*, effect on competition in the market.
35. In accordance with the reasoning of the Court of Appeal, the Commission concludes that the expansion of DEL's monopoly over a larger geographical area will not change the character of its dominance or have any effect on competition. Accordingly the acquisition will not have the effect, or likely effect, of substantially lessening competition in the market.

Electricity Lines Maintenance and Contracting Services

36. As both the acquirer and the target company have lines maintenance and contracting services subsidiaries, namely DUSL and OPSL, the Commission also investigated the likely effect of the merger on competition in the South Island market for the provision of lines maintenance and contracting services. The Commission found the market to be readily contestable, and as such, any aggregation caused by the proposed merger does not give rise to competition concerns.
37. Accordingly, the Commission considers the acquisition will not have the effect, or likely effect, of substantially lessening competition in the South Island market for the provision of electricity lines maintenance and contracting services.

OVERALL CONCLUSION

38. 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 Dunedin market for the provision of electricity lines services to electricity retailers;
 - The Central Otago market for the provision of electricity lines services to electricity retailers;
 - The South Otago market for the provision of electricity lines services to electricity retailers; and
 - The South Island market for the provision of electricity lines maintenance and contracting services.

DETERMINATION ON NOTICE OF CLEARANCE

39. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Dunedin Electricity Limited of up to 100% of the assets or shares of Otago Power Limited, including the assets and shares of its wholly owned subsidiary Otago Power Services Limited.

Dated this 6th day of December 2001

PR Rebstock
Acting Chair