

Commerce Commission

Decision No. 387

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

TRANSALTA NEW ZEALAND LIMITED

The Commission:

M J Belgrave
K M Brown
E M Coutts
E C A Harrison
P R Rebstock

Summary of Application:

Natural Gas Corporation Holdings Limited (or an interconnected body corporate) has sought clearance to acquire shares and capital notes equating to a 75.8% shareholding in TransAlta New Zealand 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:

17 March 2000

<p>CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS</p>
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THE PROPOSAL

- 1 Pursuant to section 66(1) of the Commerce Act 1986 (the Act), Natural Gas Corporation Holdings Limited (NGC) gave notice to the Commission dated 25 January 2000, seeking clearance for it to acquire 187,403,777 ordinary shares and 81,394,407 capital notes in TransAlta New Zealand Limited (TransAlta) and certain project debt in respect of the Taranaki Combined Cycle project, from TEC Investments Limited and Trans New Zealand Energy Limited. These shares and capital notes represent a 75.8% shareholding in TransAlta.

Undertaking

- 2 On 17 March 2000 NGC provided to the Commission a Deed which contains an Undertaking pursuant to s 69A of the Act. A copy of the Deed is attached as Appendix 1 to this determination.

- 3 Section 69A states:

Commission may accept undertakings –

- (1) In giving a clearance or granting an authorisation under section 66 or section 67 of this Act, the Commission may accept a written undertaking given by or on behalf of the person who gave notice under section 66(1) or section 67(1) of this Act as the case may be, to dispose of assets or shares specified in the undertaking.
 - (2) The Commission shall not accept an undertaking in relation to the giving of a clearance or the granting of an authorisation under section 66 or section 67 of the Act, other than an undertaking given under subsection (1) of this section.
 - (3) An undertaking given to the Commission under subsection (1) of this section is deemed to form part of the clearance given or the authorisation granted in relation to the acquisition to which the undertaking relates.
- 4 The Commission is satisfied that the Undertaking in the Deed has been given on or on behalf of the applicant in this case, and that it relates to the disposal of assets or shares. Accordingly the Commission is able to accept the Undertaking in accordance with s 69A(1). The Undertaking forms part of the application considered below.
- 5 In brief, under the Deed NGC and its parent The Australian Gas Light Company (AGL) have undertaken that AGL will dispose of AGL's Hutt/Mana gas distribution system by 1 October 2001. The Deed provides however that the disposal is not required if TransAlta has previously disposed of its residential gas business or at least 50% of its residential gas customers or 50% of sales of gas by volume to residential consumers.
- 6 In accepting the timeframe for the Undertaking, the Commission has taken into account the special circumstances surrounding this case, including the nature and size of the asset to be divested and the current state of the market facing such a disposal, given that Orion New Zealand Limited (Orion) currently has its gas distribution systems on the market.

- 7 The acceptance by the Commission of a period of up to 18 months for the particular assets in this case should not be taken as a general precedent for any future undertakings under s 69A of the Act.

Deed Poll

- 8 During the course of the consideration of this application, NGC provided to the Commission a copy of a Deed Poll which was executed by AGL NZ Energy Limited. The Deed Poll included the following provisions:
- A price cap whereby AGL would not increase the price of network services for five years;
 - AGL would, at a network user's request, offer the same terms and pricing mechanism as the AGL Network Services Agreement of 31 March 1999;
 - the prices or terms offered to a network user would be available to any other user for the same service;
 - AGL would appoint an independent monitor to receive and report on complaints about access to the distribution system or customer switching, and to monitor and report on the development of competition; and
 - the Deed Poll shall lapse in the event that the Commerce Commission does not hold that it is necessary basis for granting a clearance¹.
- 9 The Commission understands that the Deed Poll will not now come into force as the conditions for its coming into force do not apply. Hence the Deed Poll is not discussed further in this decision.

THE PARTIES

Natural Gas Corporation Holdings Limited

- 10 NGC is a listed company, the largest shareholder of which is AGL with a 71.6% interest. Infratil 1998 Limited has a 6.34% shareholding. The public and institutions hold the remaining 22.06% of the shares.
- 11 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 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. NGC owns 100% of Energy Waikato Limited, which retails electricity, principally in the Waikato region.

The Australian Gas Light Company

- 12 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

¹ The Commission took the view that this provision rendered the Deed Poll akin to a behavioural undertaking.

Zealand, AGL has a management contract to manage the distribution and retail businesses of NGC. In 1999 AGL purchased TransAlta's gas distribution network. AGL has a 21.7% shareholding in TrustPower Limited, an electricity generating and retailing company.

TrustPower Limited

13 TrustPower Limited (TrustPower) is an electricity retailer and generator. It is the incumbent retailer in Tauranga, Rotorua and Taupo. As a result of a number of acquisitions over the past year it is also the incumbent retailer in significant parts of the South Island, northern Hawkes Bay and part of Waikato.

14 At the time of the application shareholders in TrustPower were:

Tauranga Electricity Consumers Trust	22.7%
Infratil	25.8%
AGL	21.7%
Alliant International	15.7%
Others	14.2%

15 AGL is a party to a standstill and equalisation agreement with Alliant and Infratil relating to shareholdings in TrustPower and the appointment of directors in TrustPower. The agreement provides for AGL to support the appointment of two Alliant/Infratil nominated directors of TrustPower, and for Alliant/Infratil to support two AGL/Tauranga Energy Consumer Trust nominated directors, out of a total of six directors.

AGL and TrustPower as Associated Persons

16 The application states that "for the purposes of this notice, NGC is willing to proceed on the basis that TrustPower be treated as an associated person of NGC". NGC formally reserves its position as to whether it is associated within the meaning of the Commerce Act.

17 Sections 47(2) and (3) of the Act provide:

"(2) For the purposes of this section and section 48 of this Act, where 2 or more persons are interconnected or associated and together are in a dominant position in a market, each of them is deemed to be in a dominant position in that market.

(3) For the purposes of this section and section 48 of this Act, a person is associated with another person if that person is able, whether directly or indirectly, to exert a substantial degree of influence over the activities of the other."

18 It is the Commission's view that a company which owns or controls 20% or more of the voting power in another has, prima facie, a substantial influence over that other company². In this case, AGL has a 21.7% shareholding, and is a party to an agreement with other shareholders as to levels of shareholding and the appointment of directors. The Commission considers that these links are sufficient for it to regard AGL and TrustPower as associated persons.

² Commerce Commission Business Acquisition Guidelines 1999, page 10.

19 The analysis in this decision is carried out on this basis.

TransAlta

- 20 TransAlta is an energy company with operations principally in electricity generation and wholesaling, electricity retailing, and gas retailing. It is a public company listed on the stock exchange. TEC Investments Limited and Trans New Zealand Energy Limited have a 75.8% shareholding in TransAlta. Hutt Mana Energy Trust owns 14.6% of the shares and the public and institutions hold 9.6%.
- 21 TransAlta is the incumbent electricity retailer in the greater Wellington area (including the Hutt Valley and Porirua), Christchurch and parts of Auckland. It retails gas in the Hutt Valley and Porirua areas, referred to in this decision as Hutt/Mana.
- 22 TEC Investments Limited and Trans New Zealand Energy Limited are wholly owned subsidiaries of TransAlta Corporation of Canada. The sale of TransAlta Corporation of Canada's New Zealand interests is part of a decision to focus on its generation and transmission businesses.

PROCEDURES

- 23 The application was registered by the Commission on 26 January 2000. 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 9 February 2000. The Commission and NGC agreed to extensions of the period, with the Commission's determination being required by 17 March 2000.
- 24 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 26 January 2000 prohibiting the publication or communication of that information.
- 25 The Commission's determination is based on an investigation conducted by its staff and the information subsequently provided by staff to the Commission.

INVESTIGATION

- 26 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);
 - Fletcher Challenge Energy;
 - Industrial Gas Users' Group;
 - Major Electricity Users' Group;
 - Meridian Energy (Meridian);
 - Nova Gas Ltd (Nova Gas);

- Orion New Zealand Limited;
- Rod Crone Consulting;
- Todd Energy Ltd (Todd Energy)/Fresh Start;
- TransAlta;
- Wanganui Gas Limited; and
- Large gas consumers in the Hutt/Mana area.

27 In addition staff have sought and received comment and further information from NGC.

MARKET DEFINITION

28 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.

29 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)

30 In determining relevant markets, the *Business Acquisitions Guidelines* states 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)

31 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)

Identifying Relevant Markets

- 32 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.
- 33 Thus the relevant market can vary depending on the matter at issue. As stated in the AMPs A case;

‘The boundaries {of the market} should be drawn by reference to the conduct at issue, the terms of the relevant section or section, and the policy of the statute. Some judgment is required, bearing in mind that “market” is an instrumental concept designed to clarify the sources and potential effects of market power that may be possessed by an enterprise.’

- 34 The business activities of TransAlta and of NGC, its parent AGL, and its subsidiaries and associated companies, are set out in the application. The principal activities are summarised below.

NGC

- the treatment and conditioning of gas at Kapuni;
- the wholesaling of gas to gas retailers;
- the transmission of gas throughout the North Island;
- the distribution of gas over gas networks in the Central North Island, Gisborne, Bay of Plenty, Northland and the Kapiti Coast;
- the retailing of gas in the Central North Island, Gisborne, Bay of Plenty, Northland, Kapiti Coast and Taranaki;
- the operation of the AGL-owned gas distribution network in Hutt/Mana;
- the retailing of electricity, principally in Central Waikato;
- the generation of electricity through a 50% interest in the Kapuni Energy Joint Venture; and
- the distribution of bulk LPG, propane and butane through subsidiary companies Liquigas and Propane Gas.

AGL

- the distribution of gas in Hutt/Mana.

Wanganui Gas

- the distribution and retailing of gas in the Wanganui/Rangitikei areas.

TrustPower

- the retailing of electricity throughout New Zealand; and
- the generation of electricity.

TransAlta

- the retailing of gas in Hutt/Mana and Wellington;
- the retailing of electricity, principally in Auckland, Thames Valley, Hutt/Mana, Wellington and Christchurch; and
- the generation of electricity.

Separate Electricity and Gas Product Markets

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

“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”. (para.129)

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

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

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

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

38 In subsequent decisions⁴ the Commission in each case considered it appropriate to adopt discrete product markets for electricity and gas. The Commission recognised that while inter-fuel competition provided some constraint on each energy form, it did not consider the constraint sufficiently strong to include electricity and gas in the same market.

39 In the current case, the applicant has stated in para 9.3:

“... NGC continues to question the continued appropriateness of some market definitions {adopted by the Commission} given the changes that have occurred in the energy sector. ... We believe that there is a strong case for one North Island gas retail market, or even a national energy market.

NGC believes that the requirements for the grant of clearance are satisfied if the market definitions adopted to date by the Commission are followed, or if NGC’s alternative view of there being one North Island gas retail market or indeed a national energy market was accepted by the Commission.”

40 The Commission recognises that there have been important changes in the energy sector which can impact on factors relevant to substitutability between energy forms. For instance several retailers have begun, or have announced an intention to begin,

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

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

offering electricity and gas together. These retailers include Fresh Start, TransAlta, Contact and NGC-WEL.

- 41 Also gas is an important fuel for electricity generation. Huntly (1000 MW) Otahuhu B (395 MW) Stratford/TCC (350 MW) and Southdown (115 MW) which together represent more than a fifth of the country's generation capacity are major generation plants which have gas as their primary fuel. A change in the cost of gas will have an important influence on the cost of electricity and on wholesale electricity prices at least in the short to medium term. Equally, demand for gas from electricity generators affects its availability and price for other uses.
- 42 However, 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. From information received during the course of the investigation of the current application, the Commission does not consider that a small, say five percent, increase in price of one energy form for a period of, say, one year would result in sufficient switching to the other energy form to make the price increase unprofitable.
- 43 Nevertheless the Commission recognises that there continue to be major changes in the energy sector. It will continue to monitor the situation closely to determine whether there is a case for changing its product market definition in the future.

Electricity Generation and Wholesaling

- 44 NGC, TrustPower and TransAlta all have electricity generation interests.
- 45 The Commission has previously considered electricity generation in the context of the national electricity generation and wholesaling market. This is the market in which the generators and buyers of wholesale electricity interact to determine the prices and quantities traded. The buyers are electricity retailers (some of which are vertically integrated with particular generators) and large industrial consumers of electricity (or their agents) which buy at wholesale.
- 46 This market is considered appropriate for the consideration of electricity generation issues arising from the proposed acquisition.

Electricity Retailing

- 47 The national electricity retail market is the market formed between retail suppliers on the one hand and end users on the other. Until recently, the Commission considered that there were two such retailing markets: one for larger and medium-sized customers (ie: industrial and larger commercial) with time-of-use meters, which was regarded as contestable (consumers were not restricted to buying from the incumbent lines operator cum retailer); and one for small customers (ie: small businesses and households), with non-time-of-use meters, which was regarded as non-contestable. The former was thus a nationwide market, while the latter was restricted to the area covered by the distribution network of the incumbent retailer.

48 In its decision on Contact and Enerco⁵ dated 10 December 1998, the Commission considered the changes which had occurred, and which were continuing to occur, with respect to electricity retailing, and the implications for defining the relevant markets. The Commission was, and remains, satisfied that:

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

- the lowered barriers to new entry due to the separation by legislation of electricity lines businesses and supply businesses;
- the emergence of significant new players in the marketplace who have signalled their intention to compete against incumbent retailers; and, most significantly,
- the Government’s stated commitment to ensuring that small electricity consumers benefit from competition, and its expectation that deemed profiling be introduced (either by the industry participants or, if necessary, by itself) in the near future.

49 In assessing the current application, the Commission adopts the same market definition as in Decision 333 and subsequently; that is the national electricity retail market.

Gas Transmission

50 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.

51 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 Wholesaling

52 In recent decisions the Commission has defined this market as including gas sales to retailers and to medium and large consumers. It did this in recognition that these gas purchasers are able to source their gas from a range of potential suppliers. On the supply side, substitution between these categories of purchasers appeared relatively straightforward.

53 The boundary between medium and large consumers which fell within the “wholesale” market, and small consumers which fell within the “retail” market was set at 10 terajoule (TJ) (the amount of gas that might be used over a year by, for example, a medium-sized dry cleaning business). Until recently the consumers using less than 10 TJ were limited to acquiring gas from their local gas utility.

⁵ Decision 333, Contact Energy Ltd and Enerco New Zealand Ltd, 10 December 1998.

- 54 While that definition of wholesale and retail markets assisted in addressing the issues in the earlier cases, the Commission considers that with changes in the gas trading environment and the circumstances of the case under consideration, it is now more appropriate to limit the wholesale market to what is more commonly understood to be wholesale trading – the sale of gas in large quantities to retailers of that gas. There are distinctions between the wholesale function and retail function (for instance, the size of the transactions, the number of customers involved, different contractual arrangements, etc) which mean that a separation of these functions is appropriate to highlight any competition concerns at each functional level.
- 55 While NGC is an important player in the wholesale market (as now defined), TransAlta is not. TransAlta is not a supplier to that market, and no market aggregation would arise from the proposed acquisition. Accordingly the Commission has not given further consideration to the wholesale market in this decision.

Gas Distribution

- 56 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 TransAlta is the principal retailer using that network. As TransAlta has no gas business outside Hutt/Mana, the only gas distribution market affected by the proposed acquisition is that encompassing Hutt/Mana.
- 57 Until Decision 333, 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 gas utilities resulting in the ownership separation of gas distribution and retail businesses meant that consumers would no longer necessarily receive both their distribution services and gas from a single supplier. The Commission therefore adopted separate markets for the supply of gas and the distribution of that gas. Circumstances have not changed markedly since that time and the Commission considers that separate markets remain appropriate.
- 58 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.
- 59 Nova’s gas network is more extensive in Hutt/Mana than its networks elsewhere. It now supplies many of the 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.
- 60 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 Industrial and Commercial Consumers

- 61 As discussed above, the Commission remains of the view that distribution and retailing fall within different functional markets.
- 62 In earlier decisions the Commission has placed sales of gas to consumers who take more than 10 TJ per annum in the “wholesale” market, and consumers who take less than 10 TJ in the “retail” market. The retail market therefore comprised of the sale of gas to smaller industrial and commercial consumers and to residential consumers. The average residential consumer may take around 25 GJ (0.025 TJ) of gas per annum, while a large residential consumer may take 90-100 GJ (0.09-0.1 TJ).
- 63 The Commission now considers that market circumstances have changed since it defined the wholesale and retail markets in this way. In most respects the market circumstances faced by large and small industrial and commercial consumers are similar. Large industrial and commercial consumers may be on individual contracts, have particular meter requirements, and have greater numbers of suppliers competing for their business, but now both large and small industrial and commercial consumers are likely to have competitive options available to them from retailers based in different parts of the country. Many firms operating on multiple sites in various regions now arrange their purchase of gas through one supplier. The past situation where the local incumbent retailer could often unilaterally increase prices to small industrial and commercial consumers without fear of a competitive response does not now appear to exist.
- 64 The same is not yet true for residential consumers in most areas. The supply to residential consumers has different characteristics than the supply to industrial and commercial consumers. Supplying to residential consumers usually involves operating call centres, switching and reconciliation mechanisms billing and promotional requirements, while the dollar profit margin per household is likely to be small.
- 65 For these reasons 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.

Gas Retailing to Residential Consumers

- 66 For residential consumers the Commission has concluded in the past that gas retailing falls within localised geographic markets, each corresponding with the geographic boundaries of the relevant distribution network.
- 67 NGC has suggested that there are parallels between the electricity and gas sectors. In its application it has noted that, in Decision 333, the Commission recognised that suppliers of retail electricity were no longer constrained to supplying limited geographical areas and to supplying customers on particular networks only, and that the Commission said in respect of electricity that small customers had, or would have in the near future, a choice of suppliers. The Commission therefore concluded that there was a national electricity retail market.

68 NGC has suggested that the conditions relating to electricity at the time Decision 333 was made (10 December 1998) are similar to those relating to gas retailing today. It has argued:

- there is evidence of new and potential entry in local gas retail markets;
- the current existence and operation in the distribution networks of deemed profiling, reconciliation agreements and non-discriminatory access regimes means the ability of retail customers to switch is already present as well as being technically feasible;
- progress in switching is being further progressed by the development by the gas industry of a National Gas Reconciliation Code in respect of distribution/retail which will further facilitate the development of low cost retailer to retailer transactions fundamental for small customer switching; and
- those who do not operate an open access regime would face legal and commercial issues with subscribers and would be subject to Part II of the Commerce Act.

69 NGC has stated:

“In summary, there is now both the means in place for switching, and actual evidence of switching is emerging. NGC’s view is that switching at the small customer/residential level is likely to significantly increase over the next several months.”

70 The Commission accepts that there is progress being made towards lowering barriers to entry into gas retailing markets and to making residential gas customers contestable. Nevertheless the Commission does not believe that the gas industry is yet at the stage the electricity sector was when the Commission first concluded that there was a national retail electricity market. There are some important difference between the state of the electricity retail markets at the end of 1998 and the state of gas retailing today.

71 For example, relatively few residential gas customers have switched suppliers. Fresh Start, in which Todd Energy has a significant interest, commenced operations in August 1999 and has captured around []% of all small consumers connected to the Taranaki distribution network, []% in Manawatu and []% in Wanganui. Todd has described these areas as “test markets”. TransAlta now has around [] residential consumers in Wellington, representing []% of those connected to the Wellington network, as a result of a marketing campaign commencing mid way through 1999. In other areas, including the area of relevance to the current application, Hutt/Mana, there is no significant competition for residential customers.

72 By comparison at the end of 1998, Contact and First Electric were marketing electricity to small consumers in competition with incumbent retailers, mainly at that stage in the larger population areas, and First Electric had signalled its intention to be a national retailer.

73 At the end of 1998 the Government had passed the Electricity Industry Reform Act 1998 which required the separation of line and energy in the electricity sector, and it had signalled that it would take further steps after 1 April 1999 if they were necessary to have a competitive retail electricity sector. There is no indication at present that similar legislation is likely for the gas sector.

- 74 Having regard to the above, including progress made to date in introducing competition in particular areas, the Commission anticipates that most residential consumers can look forward to more competitive markets. However, the Commission is not satisfied that this situation will necessarily flow through to other areas, such as Hutt/Mana, in a reasonable timeframe. The Commission considers that competitive issues associated with residential retailing on each network must be considered on a network by network basis.
- 75 The Commission considers that it is appropriate for the purpose of considering the current application to use a discrete Hutt/Mana market for the retailing of gas to residential consumers.

COMPETITION ANALYSIS

Introduction

- 76 The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of dominance.
- 77 Competition in a market is a broad concept. It is defined in section 3(1) of the Commerce Act as meaning “workable or effective competition”. In referring to this definition the Court of Appeal said:⁶

“That encompasses a market framework which participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency.”

- 78 Section 3(9) of the Commerce Act states:

“For the purposes of sections 47 and 48 of this Act, a person has ... a dominant position in a market if that person as a supplier ... of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is ... in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-

- (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
- (b) The extent to which that person is ... constrained by the conduct of competitors or potential competitors in that market:
- (c) The extent to which that person is ... constrained by the conduct of suppliers or acquirers of goods or services in that market.”

The Dominance Test

- 79 Section 47(1) of the Commerce Act prohibits certain business acquisitions:

“No person shall acquire assets of a business or shares if, as a result of the acquisition, -

- (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or

⁶ *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 564-565.

- (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

80 The test for dominance has been considered by the High Court. McGechan J stated:⁷

"The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."

...

"Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

81 Both McGechan J and the Court of Appeal, which approved this test,⁸ stated that a lower standard than "a high degree of market control" was unacceptable.⁹ The Commission has acknowledged this test:¹⁰

"A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction."

82 The Commission's *Business Acquisitions Guidelines* state:

"A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor {or} customer reaction."

...

"A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability."^(p21)

83 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined.

84 An important element in the competition analysis is often the market concentration following the acquisition. An examination of concentration in a market often provides a useful first indication of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.

85 The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act –

⁷ *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103, 787 (HC).

⁸ *Commerce Commission v Port Nelson* (1996) 5 NZBLC 104,142 104,161 (CA).

⁹ *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)

¹⁰ *Business Acquisition Guidelines*, Section 7

“In the Commission’s view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:

the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;

the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share.” (p 17)

- 86 These safe harbours recognise that both absolute levels of market share and the distribution of market shares between the merged firm and its rivals is relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state that:

“Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of shares, fall within these safe harbours.”

- 87 Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through market entry, also typically need to be considered and assessed.

THE MARKET FOR THE RETAILING OF GAS TO RESIDENTIAL CONSUMERS IN HUTT/MANA

- 88 This market encompasses the supply of gas to 24,500 residential gas consumers in the Hutt/Mana area. These consumers use around 520 TJ per annum and 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.
- 89 Until 1993 a system of exclusive franchises ensured that the gas retailer on each network was protected from any possibility of competition from other gas retailers. On 1 April 1993, the Gas Act 1992 came into force, franchise boundaries were abolished and retail competition for both large and small consumers was no longer prohibited.
- 90 While there are now a number of firms competing for industrial and commercial customers in Hutt/Mana, TransAlta is currently the sole retailer to residential customers.
- 91 In assessing this application, the Commission has considered whether or not TransAlta is currently in a dominant position in the market. A conclusion that TransAlta is not dominant would require the Commission to consider whether the acquisition would result in the acquisition of dominance. A conclusion that TransAlta is currently dominant would require the Commission to consider whether the acquisition would be likely to strengthen that dominance.

Assessing TransAlta's Current Market Power

92 Section 3(9) of the Act states that a person is in a "dominant position" if:

“. . . a person as a supplier or an acquirer of goods or services either alone or together with an interconnected or associated person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market . . .”

93 That section also states that a determination of dominance shall have regard to:

- market share, technical knowledge and access to materials or capital;
- the constraint exercised by competitors or potential competitors; and
- the constraint exercised by suppliers or acquirers.

Market Share

94 As noted above TransAlta is currently the only retailer selling gas to residential consumers in Hutt/Mana. This situation would not be changed by the proposed acquisition.

Constraints from Potential Competitors

Conditions of Entry

Technical Knowledge

95 The Commission does not consider that the technical knowledge required to compete in the market is such as to deter new entry.

Access to Materials and Capital

96 The necessary materials and capital required by a new entrant are not considered to be barriers to entry to the market.

Incumbent Response

97 In order to provide effective competition, a potential entrant must be prepared to enter and secure a viable position in the market against the likely response from the incumbent.

98 In this case, TransAlta as the incumbent would have the potential to utilise its knowledge of Hutt/Mana consumers to set market conditions for categories of consumers at an entry deterring level, provided those levels allowed it to meet its cost of supply.

Name Loyalty and Reputation

99 TransAlta is likely to have an advantage over new entrants as it trades under a name which is well established amongst gas consumers in the Hutt/Mana area. Potential new entrants, such as Fresh Start, may face the cost of obtaining similar name recognition and reputation if they are to compete on equal terms.

Access to Distribution Networks

100 The ability of new retailers to access the distribution network is an important factor in the consideration of competition in retail markets. NGC has said that an open access regime currently applies in the Hutt/Mana region. It argues that the open access code, which NGC, AGL and TransAlta have committed to:

“... reduces barriers to retailer entry by:

- providing a transparent and common process for handling required technical specifications for retail – and other – interconnections;
- providing for harmonisation of metering and other requirements for implementation of a gas profiling mechanism that will facilitate households switching suppliers;
- obliging the companies to provide publicly available prices and audit mechanisms for contract and price arrangement verification, and consequently raise the probability of extending the availability of negotiated favourable contracts; and
- bolstered by the disclosure requirements, enabling price benchmarking across distribution networks.”

101 The open access regime includes non-discriminatory access, deemed profiling, reconciliation arrangements, posted prices and information disclosure requirements.

Non-discriminatory Access

102 The Gas Pipeline Access Code was published in 1998 by Gas House. Gas House was formed in 1995 with voluntary membership from participants in the gas industry and contained representation from gas suppliers, pipeline owners and gas consumers.

103 The Access Code is a voluntary code of practice designed to facilitate the development of a competitive market for gas retailing. In the introduction to the code it is stated that its publication “represents the first step in the development of a code of conduct by defining a standard of behaviour and disclosure in respect of access to gas transport systems”. The code specifies minimum standards of conduct for pipeline owners and undertakings to facilitate non-discriminatory access to gas lines.

104 The code is not binding, rather it is a voluntary document. There is no legal compulsion for any person or body in the gas industry to formally support the code nor to abide by its provisions. It states that the members of Gas House decided to publish the code at this stage of its development “so that market practice could assist the code to evolve”. It also states:

“The Code is generally non-prescriptive. The advantage is that it allows each owner to develop conditions and practices that best suit an individual transport system and the needs of users. If these are considered contrary to the principles laid out in the Code, they may be challenged under the Code’s dispute resolution provisions.”

105 Important elements in the code include:

- Owners (of pipelines) shall supply any user that meets prudential requirements with any service offered, subject to the availability of capacity.

- Owners shall offer terms and conditions that facilitate access to all capacity and shall act in a neutral and non-discriminatory manner.
 - Terms and conditions must be declared in a publicly available memorandum and constitute a binding offer.
 - Each owner is required to issue an information memorandum which sets out declared terms and conditions under which the owner's system may be accessed, a description of the capacity available, engineering specifications, gas specifications etc.
 - Owners are obliged, where practical to unbundle services.
- 106 Each pipeline owner which is a signatory to the code is required to issue an information memorandum setting out the terms and conditions under which its network may be accessed. Based on this general document, the pipeline owner and gas retailers then negotiate a Network Services Agreement (NSA) which specifies the contractual relationship between them. The NSA requires the retailer to comply with the terms of the information memorandum.
- 107 One of the matters included in the information memorandum is the allocation and reconciliation procedure. Where there are two or more retailers supplying customers on the same distribution system, they share the same receipt point, which is the point where gas leaves the transmission system and enters the distribution system. Allocation is the process of establishing the quantities of gas for each retailer on the network. The retailers are required to arrive at an allocation agreement and to appoint an allocation agent who is responsible for carrying out the allocation procedure.
- 108 The NSAs which are currently in existence include specified allocation or reconciliation procedures. An industry working group has also been progressing the drafting of a reconciliation code aimed at delivering a uniform national approach to reconciliation and customer switching protocols. This may facilitate the switching of small customers. The application states that it is intended that the code be finalised in March 2000. While this target now seems unlikely, other industry participants have confirmed that the code should be in place in the near future.
- 109 Appendix 2 attached describes the various legislation, codes and contracts in a diagrammatic form, as provided by NGC.

Reconciliation Code

- 110 The reconciliation code (26 October 1999 draft) states that it was developed by a gas industry working group comprising representatives of all industry segments: transmission, distribution networks, wholesalers, retailers and those involved in billing and reconciliation.
- 111 The code sets out the rights and responsibilities of parties to the following types of arrangements:
- Those determining which party owns and/or is in possession of gas at points where it is exchanged or passes from one pipeline system to another.
 - Those determining the quantities of gas attributable to each such party
 - Those dealing with errors and disputes.

112 The code also defines the schedule of activities involved in the process and flows of information related to metered quantities, allocations and reconciliations.

113 The arrangements described above apply in the Hutt/Mana area, where AGL has an information memorandum and NSA applying to users of its network.

Information Disclosure

114 The Gas (Information Disclosure) Regulations came into force on 7 August 1997. The regulations require separate financial statements for the transmission, wholesale, distribution and retail businesses; disclosure of contract prices, terms and conditions; publication of financial, efficiency and reliability performance measures, pipeline capacity information and line charge methodologies.

115 The Ministry of Commerce is carrying out a review of the regulations. A discussion paper was released by the Ministry in October 1999¹¹, setting out its proposed changes and seeking comments on the proposals. The Ministry is considering the responses to its discussion paper.

Comment on Access to Distribution Networks

116 The pipeline access code, reconciliation code, and the information disclosure requirements have put a basic framework in place that the Commission considers has the potential to facilitate the development of competition. However, the Commission does not consider that, in their current state, they are sufficient in themselves to enable the Commission to be confident that the residential market will be subject to sustained competition within a reasonable period, say two years.

117 Access to AGL's low and medium pressure local network is by way of a Network Services Agreement (NSA), which governs the conduct, rights and obligations of AGL and a network user. This contract incorporates an Information Memorandum, which describes the pricing, technical and procedural details for transport of gas on the network. The Information Memorandum forms part of the terms and conditions of the NSA, and where the two conflict or are inconsistent, the terms of the NSA prevail.

118 The NSA is the current form of agreement between AGL and its network customers. The Commission understands that the term for the NSAs has not been specified as provided for in the NSA. This means that the NSA is a contract for an indefinite term and leaves open the possibility that AGL could terminate the agreement on reasonable notice, possibly with a view to putting a new form of agreement in place. While there is nothing improper in this, it does mean that the Commission cannot assume that the current form of the NSA will remain in place for a fixed period.

119 While there is a dispute resolution procedure provided, which applies to both the NSA and the Information Memorandum, where the methodology for setting the posted price is concerned, AGL has the sole discretion to make any final decision. It is only

¹¹ Discussion Paper, Proposals for Amending the Gas (Information Disclosure) Regulations 1997, 11 October 1999

required to consult with the network users in good faith before making any material changes that would have a material adverse effect on the Network User.

Switching Costs

- 120 Potential new entrants to the market would be disadvantaged if the process of switching gas consumers from one retailer to another involved significant costs or if the process was not a smooth one from the customer's point of view.
- 121 The switching of customers between competing retailers requires the transfer of information between competitors. As noted above, an industry working group is currently attempting to reach an agreement on a switching protocol which would apply nationally. A final agreement is said to be likely within the next few months. In the meantime, competing retailers in each area are required to reach an agreement on the exchange of information.
- 122 It is possible that consumers could also face costs on switching suppliers. There is evidence that some consumers who have switched retailers in both the electricity and gas sectors have been faced with lengthy delays in receiving their monthly bills and that they have found this unsatisfactory. While this may be a "teething" problem while retailers adjust their billing processes to the new environment, nevertheless new entrant retailers may have to overcome consumers' perception that there may be a problem with switching suppliers.

Likelihood, Extent, Timeliness and Sustainability of New Entry

- 123 The Commission has stated in its Business Acquisitions Guidelines:

"In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns of market dominance, entry of new participants in response to the exercise of market power must be likely, sufficient in extent, timely and sustainable."

This approach is called the "*lets*" test from the first letter of each element: likely, extent, timely and sustainable.

- 124 The Guidelines also state:

"The theoretical possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about dominance. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational business will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment."

"If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers in the relevant markets are detrimentally affected to a significant extent."

"The Commission considers that, for most markets, entry which cannot be achieved within two years from initial planning is unlikely to be sufficiently timely to alleviate concerns about market dominance. However the Commission will examine each case on a case-by-case basis."

“The Commission considers that generally entry is likely only if it is likely to be profitable at price levels which, in the long term, are similar to those prevailing prior to the business acquisition which might otherwise be of concern. Certainly there must be lasting economic incentive for entry.”

- 125 Having regard to the entry conditions discussed above, the Commission is not confident that sustainable new entry will be sufficiently likely in the short term (say the next two years) to prevent TransAlta from being able to exercise undue market power in that period.
- 126 In reaching this conclusion the Commission has given careful consideration to the position of potential entrants.
- 127 Contact and Fresh Start both have existing gas retail businesses. Contact retails gas in Wellington, Auckland, Manawatu, Horowhenua and Hawkes Bay. Fresh Start retails gas in Taranaki, Manawatu and Wanganui. Both also offer consumers electricity along with gas, and this may provide them with a competitive advantage over those who can supply gas alone.
- 128 While Contact has not identified any significant costs of entry, [
].
- 129 Todd/Fresh Start has stated that [
].
- 130 While other parties, such as Orion and Nova, have shown a willingness to compete for commercial and industrial gas consumers in Hutt/Mana, they have not yet demonstrated an interest in competing for residential consumers. Indeed Nova has indicated to the Commission that it is not interested in competing for residential customers at this stage.

- 131 Having regard to these matters, the Commission has not been able to conclude that TransAlta is effectively constrained by potential new entry into the market.

Constraint from Competition from Electricity and LPG

- 132 NGC has suggested that TransAlta is currently constrained by competition from both electricity and LPG.
- 133 While the Commission accepts that both alternative fuels place a limited constraint on gas in particular circumstances, it considers that this constraint is not sufficient to prevent TransAlta from having a dominant influence in the gas retail market.

Constraint from the Threat of Government Intervention

- 134 It is the perception of the Commission that the threat of Government intervention provides some constraint on the behaviour of those in the gas sector. Most sector participants spoken to appear anxious to demonstrate that the sort of government intervention that occurred in the electricity sector last year is not necessary for the gas sector. They may avoid obvious anti-competitive behaviour for this reason, as well as for the implications such behaviour might have for them under the Commerce Act.
- 135 Nevertheless, the Commission considers it can only give a small weighting to this constraint.

Constraint from Buyers or Suppliers

- 136 The Commission has not identified any current or potential ability by residential gas consumers, or gas suppliers, to exert any significant countervailing power on TransAlta.

Conclusion on Dominance, Pre-acquisition, in the Market for the Retailing of Gas to Residential Users in Hutt/Mana

- 137 The majority of the Commission has concluded that TransAlta is currently dominant in the market for the retailing of gas to residential customers in Hutt/Mana. In reaching this conclusion it has recognised that residential consumers currently have no alternative to sourcing their gas from TransAlta. 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 would be of a sufficient scale, or sufficiently timely or sustainable to prevent TransAlta from being able to exercise a dominant influence in

the market.

- 138 Commissioners Brown and Coutts however are satisfied that new entry of sufficient extent and sustainability is likely within the two years normally used by the Commission for the time dimension of the *lets* test to constrain TransAlta in the Hutt/Mana region.

Impact of the Acquisition on TransAlta's Existing Dominance

- 139 The proposed acquisition would not lead to any market aggregation in the residential retail market. The concerns raised about the potential for the acquisition to increase TransAlta's existing market power in the Hutt/Mana market relate to vertical integration. In particular it had been suggested that NGC and its associated interests, with effective control of both the distribution network and the retail business would have the ability and incentive to foreclose future competition in the residential retail market. These concerns were expressed before the Undertaking was given by the applicant.
- 140 The Commission believes that the Undertaking removes the principal basis for these concerns. The Undertaking will ensure that ownership of the network and the gas retail business will be separated. With this separation, the network owner would not have an incentive to restrict new retailers from access to its network. It would be in no different position than AGL is currently, in this respect.
- 141 The Commission recognises that some vertical integration involving the Hutt/Mana residential retail market may still arise from the acquisition. If the network divestment option is chosen (rather than the retail divestment option), NGC will be vertically integrated from its position as owner of the high pressure transmission system transporting gas to Hutt/Mana and the owner of the retailer of gas to residential customers in Hutt/Mana.

Conclusion on the Impact of the Acquisition

- 142 The Commission concludes that the proposed acquisition would not lead to market aggregation in the Hutt/Mana retail market. Further, taking into account the divestment arising from the Undertaking, it concludes that the proposed acquisition would not give rise to competition concerns from vertical integration.
- 143 Taking into account the Undertaking, the Commission concludes that the proposed acquisition would not result and would not be likely to result in a strengthening of TransAlta's dominant position 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

144 Competitors in this market include NGC, TransAlta, Orion, Contact, Todd Energy and Nova. Market shares derived from NGC's estimates provided to the Commission are shown in the following table:

Table 1

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

	TJ	Percentage
NGC	[]	[]
Wanganui Gas	[]	[]
TransAlta	[]	[]
Orion	[]	[]
Contact	[]	[]
Shell/Todd	[]	[]
Nova	[]	[]
Total	[]	100%

145 TransAlta is only a small participant in this market and the proposed acquisition would result in only a minor increase in the current market share of NGC. The post-acquisition share of NGC and its associated companies would be less than 40% and would remain within the Commission's "safe harbours". These safe harbours are spelt out in the Commission's Business Acquisitions Guidelines (and in para. 85 above) and signify market shares which are unlikely to raise dominance concerns.

146 Contact, NGC, Shell/Todd and Orion would remain as significant competitors in this market, while Fletcher Energy is a potential entrant.

147 The Commission does not consider that there are major barriers to new entry or to expansion by existing players.

148 The Commission is satisfied 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 industrial and commercial consumers.

THE HUTT/MANA GAS DISTRIBUTION MARKET

149 The Hutt/Mana gas distribution market corresponds in area with the gas distribution network owned by AGL.

- 150 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. []
- 151 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.
- 152 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.
- 153 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.
- 154 The proposed acquisition involves no aggregation in the Hutt/Mana gas distribution market, nor does it have a direct impact on bypass potential. Rather the Undertaking, which forms part of the application, will require AGL to divest its distribution network by 1 October 2001, unless TransAlta's residential gas retail business (or at least 50% of its residential customers or 50% of sales by volume to residential customers) is divested by that date.
- 155 If the distribution network is retained and the retail business is divested, the position of AGL in this market would be unchanged from the present position. The acquisition would not increase AGL's existing market power in this market.
- 156 Having regard to all relevant factors, including the Undertaking, the Commission concludes that the proposed acquisition would not result, and would not be likely to result, in the strengthening of AGL's dominant position in the Hutt/Mana gas distribution market.

NORTH ISLAND GAS TRANSMISSION MARKET

- 157 In previous gas decisions the Commission has recognised the high pressure gas transmission network as being a natural monopoly. The network is characterised by high capital costs and large sunk costs and there appears to be surplus capacity in most parts of the system. New entry is considered to be most unlikely.

- 158 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, notwithstanding that the threat of bypass, such as occurred last year, can place some constraint on its pricing behaviour in special circumstances.
- 159 In the application NGC has stated that it is widely accepted in the industry 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. Some of NGC's customers expressed concern about the access regime, but the Commission has not been provided with evidence which suggests a breach of the Commerce Act. The Commission notes that neither the Pipeline Access Code nor the Information Memorandum appear to have any contractual force.
- 160 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 materially affected by the proposal. While the proposal would remove TransAlta as a customer of NGC Transmission, it is currently a relatively small customer representing []% of NGC's transmission services. Large users of the transmission network such as Contact []% and Orion []% and smaller users such as Nova, Southdown Cogeneration, Genesis and FCE (together amounting to []%) would continue to be able to exercise any countervailing power which might be available to large customers.
- 161 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.

THE NATIONAL ELECTRICITY GENERATION AND WHOLESALING MARKET

- 162 NGC is a 50% joint venture partner with Todd Energy, in a joint venture owning a twenty megawatt steam and electricity co-generation plant at Kapuni.
- 163 TransAlta owns the Taranaki Combined Cycle (TCC) thermal power station and has a 47.5% share in the Southdown thermal power station.
- 164 TrustPower operates 31 small hydro power stations around New Zealand as well as the Tararua wind farm.

Table 2
Estimated New Zealand Electricity Generation Market
For Year Ending 31 March 2000

Generator	Amount GWh	Market Share
Contact Energy	8,387	23%
Genesis	3,840	11%
Meridian	12,724	36%
Mighty River	3,445	10%
Others	1,756	5%
TrustPower	1,170	3%
TANZ	4,318	12%
NGC	95	>1%
TOTAL	35,735	100%

Source: EnergyLink Ltd Forecasts Sept 1999

- 165 Table 1 shows estimated market shares by GWh, as forecast for the year ending 31 March 2000. The combined market share of TransAlta, TrustPower and NGC is around 15%. Other major generators are Contact with 23%, Genesis with 11%, Meridian with 36% and Mighty River with 10%.
- 166 Meridian argued that to assess the effect of the acquisition on this market it is necessary to deduct sales from generators to their vertically integrated retailers and to remove bilateral contracts. This would result in TransAlta/TrustPower being the major buyers of wholesale electricity. The Commission's view, as stated in Decision 340¹², is that the generation and wholesaling market is a very complex market, involving three interrelated forms of transactions: bilateral contracts, spot trading and reserves trading. Prices for each form of transaction are influenced closely by trading activity in the others. The Commission remains of the view that all of these types of transaction form part of the generation and wholesaling market.
- 167 The Commission considered in detail in Decision 340 the national generation and wholesaling market, and discussed market concentration and barriers to entry. That Decision also discussed special characteristics of the electricity industry which might result in a generator having market power that is not evidenced by its market share. These factors included whether market power could be exercised through gaming, exploiting transmission constraints and trading in reserves. The Commission does not consider these factors to be relevant in this matter. Of the power stations owned by NGC, TransAlta and TrustPower, only the TCC station is likely to be a marginal station on a regular basis.
- 168 The Commission has concluded that the proposed acquisition would not result, and would not be likely to result, in the acquisition or strengthening of a dominant position in the national electricity generation and wholesaling market.

¹² Decision No. 340, *TransAlta Corporation of Canada and Contact Energy Limited*, 12 February 1999.

NATIONAL ELECTRICITY RETAIL MARKET

- 169 The Commission considers that the electricity industry reforms have substantially removed the constraints on competitive activity in, and on new entry to, the national electricity retail market. Having regard to current and potential competitive activity in this market to consumers of all sizes, the Commission has previously concluded¹³ that no firm is currently dominant.
- 170 Aggregation will occur in this market as a result of the proposed acquisition. TransAlta and Trustpower are both significant participants in the retail market. NGC is only a small player, having acquired only one retail business, that of the former WEL Energy. Estimated market shares in the national electricity retail market are shown in Table 2.

Table 3

**Estimated New Zealand Electricity Retail Market
For Year Ending 31 March 2000**

Retailer	Customers	%	Sales (GWh)	%
Contact Energy	345,000	21%	4,381	18%
Genesis	155,000	9%	1,821	8%
Meridian	70,000	4%	1,124	5%
Mighty River	251,000	15%	4,188	18%
Others	45,000	3%	639	3%
TrustPower	212,000	12%	3,013	13%
TransAlta	509,000	31%	7,500	32%
NGC/WEL	67,000	4%	818	3%
TOTAL	1,654,000		23,484	

Notes:

- Excludes large and direct supply customers
- Does not account for customers who have changed retailer by choice

Source: Grant Samuel Appraisal Report on TransAlta Sept 1999

- 171 On the basis of these estimates, the combined market shares of NGC, TransAlta and TrustPower are approximately 48%. The largest competitors in the market are Contact with a 18% market share and Mighty River Power with an 18% market share. Hence the situation following this acquisition would fall within the second of the Commission's safe harbours described above.

¹³ Decision 340.

- 172 Competitive activity in this market has intensified since the time of Decision 340. The majority of New Zealand now has competition between two or more retailers. The alliance between Meridian and Sky Television offered electricity supply to Sky's pay television customers throughout the country and Meridian has stated that it intends to acquire a much larger customer base. Retailers have entered new areas as the opportunity has arisen, for example retailers beginning to supply in Northland following the price increase by the incumbent retailer (Meridian). New entry has also occurred, with Fresh Start now supplying electricity to customers in Taranaki, Wanganui, Manawatu and Wairarapa regions (along with gas in these areas where it is reticulated). As at the end of December 1999, more than 3.5% of New Zealand electricity consumers had switched retailer¹⁴.
- 173 Having regard to the level of competitive activity in this market, the Commission concludes that no firm is currently dominant. The Commission considers that Contact and Mighty River Power, as well as the smaller retailers, will continue to constrain the retail activities of a combined NGC, TransAlta and TrustPower.
- 174 The Commission concludes that the proposed acquisition would not result, and would not be likely to result, in the acquisition or strengthening of a dominant position in the national electricity retail market.

CONCLUSION

- 175 The Commission has considered the impact of the proposal in the six 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;
 - the North Island gas transmission market;
 - the national electricity generation and wholesaling market; and
 - the national electricity retail market.
- 176 Having regard to the factors set out in section 3(9) of the Commerce Act and all the other relevant factors, including the Undertaking, 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.

¹⁴ Maria Update, Issue 00/1, January 2000, M-co.

DETERMINATION ON NOTICE OF CLEARANCE

- 177 Pursuant to section 66(3) of the Commerce Act 1986, the Commission gives clearance for the acquisition by Natural Gas Corporation Holdings Limited (or an interconnected body corporate) to acquire 187,403,777 ordinary shares and 81,394,407 capital notes in TransAlta New Zealand Limited and certain project debt in respect of the Taranaki Combined Cycle project, from TEC Investments Limited and Trans New Zealand Energy Limited.

Dated this day of March 2000

M J Belgrave
Chair