



COMMERCE COMMISSION

Decision No. 569

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

ENERGY MARKET SERVICES LTD

and

THE MARKETPLACE COMPANY LTD

The Commission: Paula Rebstock
Peter JM Taylor
Denese Bates

Summary of Application: The proposed acquisition by Energy Market Services Ltd of all of the shares of The Marketplace Company Ltd.

Determination: Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline to grant clearance to the proposed acquisition.

Date of Determination: 20 December 2005

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CONTENTS

EXECUTIVE SUMMARY	I
The Proposal.....	i
The Service Provider Roles	i
Market Definition.....	ii
Counterfactual and Factual	ii
Competition Analysis.....	ii
<i>Reconciliation Manager (NRM).....</i>	iii
<i>Pricing Manager</i>	iii
<i>Clearing Manager</i>	iii
<i>Market Administration.....</i>	iii
<i>Information Systems</i>	iv
<i>Registry</i>	iv
<i>System Operator</i>	iv
<i>The Supply of Non-Regulated Electricity Data</i>	iv
System Integration.....	v
Overall Conclusion and Determination	v
THE PROPOSAL	1
STATUTORY FRAMEWORK.....	1
ANALYTICAL FRAMEWORK.....	2
THE PARTIES.....	2
<i>EMS.....</i>	2
<i>M-co.....</i>	3
OTHER PARTIES.....	4
<i>Transpower</i>	4
<i>The Electricity Commission (EC).....</i>	4
INDUSTRY BACKGROUND	4
The Wholesale Electricity Market.....	4
<i>The Services Provided under Contract to the EC.....</i>	5
INTERCONNECTION	7
MARKET DEFINITION	8
Product Markets	9
Geographic Markets	10
Temporal Dimension	10

Supply of Information to Third Parties	11
Conclusion on Relevant Markets	11
REASONS FOR THE PROPOSAL	11
FACTUAL AND COUNTERFACTUAL	13
The Factual Scenario	14
The Counterfactual Scenario	14
COMPETITION ANALYSIS	15
Market Mechanism	15
Incumbent Advantage	17
System Integration	17
Countervailing Power	18
Potential Bidders	19
COMPETITION ANALYSIS OF SPECIFIC MARKETS	21
Reconciliation Manager (NRM)	21
<i>Entry Conditions</i>	21
<i>Potential Bidders</i>	22
<i>Countervailing Power</i>	24
<i>Conclusion</i>	25
Pricing Manager	25
<i>Entry Conditions</i>	25
<i>Potential Bidders</i>	26
<i>Countervailing Power</i>	27
<i>Conclusion</i>	28
Clearing Manager	28
<i>Entry Conditions</i>	28
<i>Potential Bidders</i>	28
<i>Countervailing Power</i>	29
<i>Conclusion</i>	30
Market Administration	30
<i>Entry Conditions</i>	31
<i>Potential Bidders</i>	31
<i>Countervailing Power</i>	31
<i>Conclusion</i>	31
Information Systems Manager	32

<i>Entry Conditions</i>	32
<i>Potential Bidders</i>	34
<i>Countervailing Power</i>	35
<i>Conclusion</i>	35
Registry	35
<i>Entry Conditions</i>	35
<i>Potential Bidders</i>	36
<i>Countervailing Power</i>	36
<i>Conclusion</i>	36
System Operator	37
<i>Contestability</i>	37
<i>Entry Conditions</i>	37
<i>Potential Bidders</i>	38
<i>Conclusion</i>	40
The Market for the Supply of Non-Regulated Electricity Data	40
<i>Background</i>	40
<i>Competitive Impact of Acquisition</i>	40
<i>Conclusion</i>	42
OVERALL CONCLUSION	43
DETERMINATION ON NOTICE OF CLEARANCE	44

EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 26 September 2005. The notice sought clearance for proposed acquisition by Energy Market Services Ltd (EMS or the Applicant) of all of the shares of The Marketplace Company Ltd (M-co).

The Service Provider Roles

2. The service provider roles that are contracted by the Electricity Commission (EC) and are the subject of the application are:
 - National Reconciliation Manager (NRM) – reconciles metering data against a register of contracts and profiles domestic consumption data into half hour periods. The Reconciliation Manager issues the reconciliation results for clearing and settlement of the market. EMS is currently the Reconciliation Manager.
 - Clearing Manager – calculates the amounts of electricity bought and sold, issues invoices to purchasers and notifications to generators and provides the settlement services for these transactions. M-co is currently the Clearing Manager.
 - Pricing Manager – receives metering information from generators, produces final prices and provides final pricing information to the Clearing Manager. M-co is currently the Pricing Manager.
 - Market Administrator – the EC itself has assumed this role but subcontracts administrative support services, including collation and reporting of system operator and pricing manager reports, registering and auditing data administrators, storage of electricity profile information. The EC subcontracts for administrative support in the following areas:
 - Wholesale market – M-co currently provides these services;
 - Retail market – M-co currently provides these services;
 - Transmission workstream – M-co currently provides these services;
 - Security of supply – Concept Consulting Group (Concept) currently provides these services; and
 - Common quality – Concept currently provides these services.
 - Registry – manages the registry showing which retailer supplies each installation control point (ICP) so that energy flows between retailers can be reconciled. The registry also informs retailers when a customer switches supplier. Jade Direct New Zealand Limited (Jade) currently provides this service.
 - Information Systems Manager – provides access to the internet-based electricity trading system, COMIT. M-co is currently the Information Systems Manager.
 - System Operator (SO) – operates the New Zealand power system. Transpower is mandated as the System Operator under the Electricity Governance Rules (EGRs) until 2009.

Market Definition

3. The Commission considers that for the purposes of this application, the relevant markets are:
 - The national markets for the provision of the following services in respect of the New Zealand electricity market:
 - Reconciliation Manager;
 - Pricing Manager;
 - Clearing Manager;
 - Market Administration;
 - Information Systems Manager;
 - Registry; and
 - System Operator.
 - The national market for the supply of non-regulated electricity data.

Counterfactual and Factual

4. The Commission considers that in the factual scenario, EMS would assume all the service provider functions presently conducted by M-co. Post-acquisition, EMS/Transpower would be the exclusive provider of the following services:
 - Reconciliation Manager;
 - Pricing Manager;
 - Clearing Manager;
 - Information Systems Manager; and
 - System Operator.
5. In addition, EMS/Transpower would provide wholesale and retail market administration services to the EC. EMS/Transpower would provide these services at least until the EC goes to the market for tenders.
6. Jade would continue to provide Registry services for the duration of the existing contract and Concept would continue to provide market support and administration services in respect of common quality and security of supply.
7. The Commission considers that the relevant counterfactual for this analysis is the status quo, ie that EMS and M-co continue to operate independently and compete for the EC service provider contracts.

Competition Analysis

8. As competition for the service provider roles will be for the market rather than in the market, the Commission has modified its standard analysis of “existing competition” and “potential competition” and has instead analysed the nature of competition by identifying the likely potential bidders for future contracts, and the extent of competition these bidders would likely provide under the factual and the counterfactual scenarios.

Reconciliation Manager (NRM)

9. The Commission considers that in the counterfactual scenario there would be two strong competitors in EMS and M-co, as opposed to the factual scenario where M-co would no longer exist.
10. The Commission considers that there would be insufficient constraint from the countervailing power of the EC in these circumstances.
11. To this extent, the Commission considers that post-acquisition, if not at the next bidding round but most likely at the next, EMS would likely have the ability to increase its prices and/or cease innovating its systems such that it gives rise to a drop in quality that might have existed in the counterfactual scenario.
12. Accordingly, on balance, the Commission cannot be satisfied that the proposal would not result or would not be likely to result in a substantial lessening of competition in the reconciliation market.

Pricing Manager

13. The Commission considers that in the counterfactual scenario, if EMS really wanted the Pricing Manager contract (as it seems to indicate that it would in order to protect its NRM and SO roles), it would likely invest in the necessary expertise to submit a credible bid, and bid aggressively for this contract. However, the Commission considers that in the factual scenario, the merged entity would be unlikely to face competition from a credible bidder. As such, the Commission considers that the EC would have significantly less countervailing power in the factual compared to the counterfactual.
14. Accordingly, the Commission concludes that, on balance, it cannot be satisfied that the proposal would not result or would not be likely to result in a substantial lessening of competition in the Pricing Manager market.

Clearing Manager

15. In the factual scenario, the Commission is, on the information available, unsure whether another party would bid for the Clearing Manager contract, given the uncertainty of securing a licence for the use of the existing CHASM system, and the cost and lead time required for the development of a new system. However, the Commission considers that in the counterfactual, it is likely EMS would bid for this contract. Under the factual scenario then, the number of potential credible bidders would reduce from two to one.
16. In time, this would significantly reduce the countervailing power of the EC in the factual as compared to the counterfactual scenario.
17. Accordingly, the Commission considers that in respect of the Clearing Manager market, on balance, the Commission cannot be satisfied that the acquisition would not give rise to a substantial lessening of competition.

Market Administration

18. The Commission is of the view that barriers to entering this market are low and that sufficient credible bidders exist. The prospect of Transpower integrating the MO and SO functions are unlikely to raise entry barriers in relation to these services. In addition, the Commission considers that in the factual scenario, the EC would continue to have countervailing power and could easily exercise that

power. The removal of M-co as a separate bidder in the factual is unlikely to have a significant impact on the future state of competition compared to the counterfactual.

19. Accordingly, the Commission considers that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the market for administration support services.

Information Systems

20. The Commission is of the view that the proposal would reduce the number of likely credible potential bidders for the Information Systems Manager contract from two to one. As such, the Commission considers that this would lessen significantly the EC's countervailing power in the factual as compared to the counterfactual scenario.
21. Accordingly, on balance, the Commission cannot be satisfied that the proposed merger will not have, or would not be likely to have, the effect of substantially lessening competition in the Information System Manager market.

Registry

22. The Commission considers that if the acquisition proceeded, Jade would face one fewer potential bidders than in the counterfactual but the combined entity would continue to provide competitive constraint on Jade as the provider of the registry function. Furthermore, the barriers to carrying out this function are not so high as to preclude other developers of databases and registry systems from submitting credible bids for the performance of this function either in the proposed 2006 tender round or at future rounds.
23. Therefore, the Commission concludes that the acquisition is unlikely to result in a substantial lessening of competition in the market for the Registry service provider contract.

System Operator

24. The Commission cannot ignore the fact that Transpower views M-co as the main competition to the System Operator role, in the medium to long term.
25. In addition, the Commission cannot be satisfied that the acquisition would not enhance the ability of EMS to combine all of the services with Transpower's System Operator function in such a way as to raise substantially, the barriers to entering the SO role.
26. The Commission therefore concludes that it cannot be satisfied that the acquisition would not or would not be likely to result in a substantial lessening of competition in the market for the System Operator role in the future.

The Supply of Non-Regulated Electricity Data

27. The Commission considers that the present pricing issue surrounding access to this data is one that would exist in the counterfactual as well as the factual scenario.
28. Accordingly, the Commission considers that compared to the counterfactual, the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the market for the supply of non-regulated electricity data.

System Integration

29. The Commission cannot be satisfied that the acquisition would not enhance the ability of EMS to combine all of the services with Transpower's System Operator function in such a way as to raise substantially, the barriers to entering any or all of the MO functions.

Overall Conclusion and Determination

30. The Commission concludes that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the markets for the provision of the following services in respect of the New Zealand Electricity Market:
- Market Administration;
 - Registry; and
 - the provision of non-regulated electricity data.
31. In the remaining markets, the Commission concludes that the proposed acquisition would reduce the number of likely potential bidders from two strong potential competitors in the counterfactual, to one in the factual. In addition, the Commission considers that the removal of M-co in the factual scenario is likely to lessen significantly the countervailing power of the EC.
32. In addition, the Commission cannot be satisfied that the acquisition would not enhance the ability of EMS to combine all of the services with Transpower's System Operator function in such a way as to raise substantially, the barriers to entering any or all of the MO functions.
33. Further, the Commission considers that by integrating the SO and MO functions, EMS could increase significantly the barriers to entering the SO role, thereby reducing the contestability of the SO role in future.
34. For these reasons, the Commission cannot be satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in the following markets:
- The national markets for the provision of the following services in respect of the New Zealand Electricity Market:
 - Reconciliation Manager;
 - Pricing Manager;
 - Clearing Manager;
 - Information Systems Manager; and
 - System Operator.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 26 September 2005. The notice sought clearance for proposed acquisition by Energy Market Services Ltd (EMS or the Applicant) of all of the shares of The Marketplace Company Ltd (M-co).
2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Extensions of time were agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 21 December 2005.
3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held:

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, ie dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³
7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is not minimal.⁴

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

⁴ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.
9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
 - with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).
11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. As stated above, the issue is whether there is a substantial difference between the two (ie a considerable and sustainable change). The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:
 - existing competition;
 - potential competition; and
 - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

EMS

12. EMS is a wholly-owned subsidiary of Transpower New Zealand Limited (Transpower). It was established by Transpower in 1998 as d-Cypha, following Transpower's reappointment (by competitive tender) as Reconciliation Manager. In 2004 d-Cypha changed its name to EMS.

13. EMS's primary business is its role as the Reconciliation Manager for the wholesale electricity market. EMS also provides certain other data information services to electricity industry participants, including data administration, network reporting and geographical/spatial services work. It currently provides these services to []. In addition, EMS works with the Sydney Futures Exchange (SFE) to offer electricity futures and options contracts in respect of electricity in Queensland, New South Wales, Victoria and South Australia.
14. EMS has been involved in tenders to provide market system services for electricity and gas systems in other jurisdictions but does not currently provide these services internationally.

M-co

15. M-co was established in 1993 by the electricity industry to assist in the design and implementation of the wholesale electricity market. M-co was originally owned by Transpower, ECNZ and the Electricity Supply Association (representing electricity lines companies). When ECNZ was split into three state-owned generators, M-co was sold to RMB Australia which then on-sold it to another related company, M-co International Limited (MIL), M-co's current owner. MIL is owned by a South-African based international financial group.
16. M-co is also the majority shareholder in Efficient Market Services Ltd, which operates Unlisted, an internet-based trading platform for trading shares in small-to-medium sized companies. The Applicant informed the Efficient Market Services does not form part of the acquisition and will therefore be retained by M-co.
17. Following the establishment of the NZEM, M-co's primary role was to operate and administer the market under the NZEM rules. Since the Electricity Commission (EC) assumed responsibility for market operation and administration, M-co's role has been reduced. It now occupies three of the service provider roles:
 - Pricing Manager;
 - Clearing Manager; and
 - Information Systems Service Provider.
18. M-co also provides market support services for the wholesale and retail markets and the transmission work stream. []

].

19. M-co's other electricity industry activities include:
 - providing additional market information services, including a line settlement and billing system for Orion New Zealand Limited and an electricity derivatives hedge market information system for generators;
 - providing consultancy services to the Electricity Commission;

- providing value-added services to various market participants who have access to M-co's the internet-based trading system, COMIT, including access to dispatch prices, hydro reports etc; and
 - an access agreement with Transpower allowing Transpower to access COMIT to enable it to perform System Operator functions.
20. M-co has in the past assisted MIL with the provision of market design and administration services to electricity markets in other jurisdictions. It continues to provide specialist advice and support on a commercial basis when requested but is no longer actively involved in ongoing operations.
21. M-co is also involved in various market design and administration services in other industries including assisting in the design of the competitive gas market in New South Wales and ACT, and acting as finance and administration manager for that market.

OTHER PARTIES

Transpower

22. Transpower, EMS's parent company, is the owner and operator of the national transmission system. Transpower is also the System Operator. The Electricity Governance Regulations and Rules 2003 (EGRs) require that Transpower be appointed to the System Operator role. Transpower has a licence agreement with M-co under which Transpower licences its Scheduling, Pricing and Despatch model (SPD) to M-co enable it to perform its Pricing Manager role.

The Electricity Commission (EC)

23. The EC was established in 2003 to oversee the electricity industry and markets. This was in response to the industry's failure to reach agreement on the Electricity Governance Board (EGB) rules.
24. The EC is required to appoint service providers to the roles outlined below. When the EC assumed responsibility for market operation it chose not to retender these roles but awarded new contracts to the incumbent service providers. (This decision was the subject of an inquiry by the Auditor-General which, although identifying deficiencies in documentation and procedures, did not find evidence of any failure to comply with statutory obligations, or lack of probity or financial prudence.) Most of these contracts had a minimum term but these have now expired and all except the System Operator contract are now terminable on six months' notice. The EC has begun the process of organising a competitive tender for all except the System Operator contract, to take place in 2006.

INDUSTRY BACKGROUND

The Wholesale Electricity Market

25. There has been a competitive wholesale electricity market in New Zealand since 1996. The market began as a multilateral trading arrangement, the New Zealand Electricity Market (NZEM).

26. Alongside NZEM there operated the Metering and Reconciliation Information Agreement (MARIA), which facilitated bilateral trading, and the Multilateral Agreement on Common Quality Standards (MACQS), both developed and governed by the industry.
27. M-co was established by the industry to assist in the design and implementation of NZEM and, once NZEM had commenced operations, to operate and administer the market. Transpower was appointed as System Operator and Reconciliation Manager.
28. Following the Ministerial Inquiry into the electricity industry in 2000, the Government was concerned that the existing industry arrangements did not provide for the effective management of the sector or ensure security of supply in dry years. It supported the creation of a revised self-governance structure, bringing together NZEM, MACQS and MARIA under an Electricity Governance Board (EGB), but announced that, should the industry fail to reach agreement on a self-regulatory framework, it would introduce statutory regulation.
29. EGB rules were developed but the industry failed to approve them so, in 2003, the Government established the EC to take over governance of the electricity industry. In March 2004, NZEM and MARIA ceased operations and the EC assumed responsibility for operating the electricity market.

The Services Provided under Contract to the EC

30. The EGRs require the EC to appoint service providers (which may include itself) to the following roles:
 - Reconciliation Manager – reconciles metering data against a register of contracts and profiles domestic consumption data into half hour periods. The Reconciliation Manager issues the reconciliation results for clearing and settlement of the market. EMS is currently the Reconciliation Manager.
 - Clearing Manager – calculates the amounts of electricity bought and sold, issues invoices to purchasers and notifications to generators and provides the settlement services for these transactions. M-co is currently the Clearing Manager.
 - Pricing Manager – receives metering information from generators, produces final prices and provides final pricing information to the Clearing Manager. M-co is currently the Pricing Manager.
 - Market Administrator – the EC itself has assumed this role but subcontracts administrative support services, including collation and reporting of system operator and pricing manager reports, registering and auditing data administrators, and storage of electricity profile information. The EC subcontracts for administrative support in the following areas:
 - Wholesale market – M-co currently provides these services;
 - Retail market – M-co currently provides these services;
 - Transmission workstream – M-co currently provides these services;

- Security of supply – Concept Consulting Group (Concept) currently provides these services; and
 - Common quality – Concept currently provides these services.
 - Registry – manages the registry showing which retailer supplies each installation control point (ICP) so that energy flows between retailers can be reconciled. The registry also informs retailers when a customer switches supplier. Jade Direct New Zealand Limited (Jade) currently provides this service.
31. The sixth service provider role mandated under the EGRs is that of System Operator. The EGRs require the EC to appoint Transpower to this role. In other words Transpower will continue to have a monopoly over this service unless the EGRs are amended, which would require a decision by the Government.
 32. The EC has also appointed an Information System Manager, who provides access to COMIT. M-co is currently the Information System Manager.
 33. The EC’s consent is required to any deemed assignment of these contracts, including a change of control of M-co, and has been granted in this case [].
 34. The providers, values and expiry dates of these contracts are set out in Table 1 below.

Table 1: Details of Present Service Provider Roles

Role	Service Provider	Income per annum (\$m)	Totals by Service Provider (\$m)	Contract Expiry Date
System Operator and SPD	Transpower as System Operator	21.4	21.4	28/02/09
Reconciliation Manager	EMS	1.9	1.9	Six months*
Pricing Manager	M-co	1.9	[]	1/9/05 ⁺
Clearing and Settlement	M-co	1.4		28/2/06 ⁺
COMIT Market System	M-co	[]#		28/02/06 ⁺
Market Administration support services	M-co and Concept Consulting	1.3		1/12/06
Registry	Jade (Aoraki Corporation)	0.6		0.6
Total			[]	

* Contracts are perpetual with six months notice of termination

⁺ Contracts had minimum term of 18 months but are now terminable with six months notice of termination

[]

INTERCONNECTION

35. In its consideration of acquisitions, the Commission must determine the identity of the person making the acquisition. Section 47(2) provides that, for the purposes of s 47(1), a reference to a person includes two or more persons that are interconnected or associated.
36. Section 2(7) of the Act provides for when bodies corporate are deemed to be interconnected and it states:
- (7) For the purposes of this Act, any 2 bodies corporate are to be treated as interconnected if—
 - (a) one of them is a body corporate of which the other is a subsidiary (within the meaning of sections 158 and 158A of the Companies Act 1955 or sections 5 and 6 of the Companies Act 1993, as the case may be); or

- (b) both of them are subsidiaries (within the meaning of those sections) of the same body corporate; or
 - (ba) both of them are entities referred to by any of the paragraphs (other than paragraph (e)) of the definition of “transferor” in section 2(1) of the Health Sector (Transfers) Act 1993; or
 - (c) both of them are interconnected with bodies corporate that, in accordance with paragraph (a) or paragraph (b) of this subsection, are interconnected—
- and “interconnected bodies corporate” has a corresponding meaning.

37. Section 5 of the Companies Act 1993, as relevant, provides:

5. Meaning of “holding company” and “subsidiary”—

- (1) For the purposes of this Act, a company is a subsidiary of another company if, but only if,
 - (a) that other company
 - (i) is in a position to exercise, or control the exercise of, more than one-half the maximum number of votes that can be exercised at a meeting of the company; or
 - (ii) holds more than one-half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital;

38. EMS is a subsidiary of Transpower through the effect of s 5(1)a(ii) of the Companies Act 1993, as Transpower owns 100% of the shares of EMS. These two bodies, by way of s 2(7)(a) of the Commerce Act 1986, are deemed to be interconnected.

39. Accordingly, for the purposes of this application, the Commission considers that Transpower and EMS act as one head in the market.

MARKET DEFINITION

40. 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.

41. For competition purposes, a market is defined to include all those suppliers, and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.⁵

⁵ Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association* (1976) 25 FLR 169; *Telecom Corporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 (reversed on other grounds).

Product Markets

42. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. The Commission usually employs the SSNIP test to assess the scope for demand- and supply-side substitution. That is, the Commission asks, would a five to ten percent price rise, by a hypothetical monopolist, sustained over a year, induce substitution by buyers or near competitors? The point at which the SSNIP becomes profitable for the hypothetical monopolist defines the boundary of the relevant market since no potential substitute beyond this point is sufficiently close to constrain the SSNIP.
43. In this instance the 'products' in question are principally services the EC acquires for the efficient functioning of electricity related markets. Currently EMS provides the reconciliation manager service to the EC, while services provided by M-co are the clearing manager, the pricing manager, information system manager and some market administration functions. The parent of EMS, Transpower, undertakes the system operator function. These functions are described in detail above.
44. Each of these functions is defined in detail in the contract drawn up by the EC. Each requires particular expertise and resources that can vary significantly between functions. The EC is the only purchaser of such services.
45. Competition between potential suppliers of these services arises when the EC puts the contracts out for tender, which may be every two to five years. The SSNIP test relevant to this analysis asks whether a five to ten percent increase in the amount bid in a tender by a hypothetical monopoly supplier would result in either the EC substituting an alternative service (i.e. it seeks to determine whether there is ready demand-side substitution), or a supplier of another service switching to provide the service in question (i.e. it seeks to determine whether there is ready supply-side substitution).
46. The Applicant has argued⁶ that while none of the services provided by EMS and M-co under contract to EC is substitutable from the demand-side, there is a considerable degree of substitutability on the supply-side between the services provided by EMS and M-co respectively. It considers that rather than having discrete markets for each type of service, it is more realistic to define the market as the whole group of administration and data information services that are necessary for the functioning of a tradeable electricity market, including the design and establishment of tradeable markets and administration and operational functions such as clearing and settlement, reconciliation etc.
47. The Commission accepts that there is no demand-side substitution. One type of service is not an acceptable alternative for another type of service.
48. The application argues that on the supply side there is considerable degree of supply-side substitution between the services provided by EMS and M-co respectively. It also suggests that the purchaser of the services (the EC) is unlikely to purchase a single service in isolation, but will need to purchase the entire range of services in order for the market to function effectively. It further suggests that,

⁶Application - paragraph 11.2

therefore, it is more realistic to define the market as the whole group of administration and data information services that are necessary for the functioning of a tradeable market.

49. The Commission has discussed issue relevant to market definition with M-co and EMS, with service providers and with the Australian provider of these services (NEMMCO). It is apparent that some of the skills and resources necessary to provide one service are also required to provide some of the other functions. A full understanding of the workings of the electricity market is a necessary attribute for most service provider roles. Some functions require the provider to make a considerable capital investment in software and IT; others require the provider to have general management and organisational expertise.
50. As discussed in the competition analysis below, a firm with an existing involvement in the electricity sector has important advantages (knowledge, reputation, etc) over other firms seeking to become a service provider. However, a firm providing one service would need additional skills and/or resources to provide other services. For example [

].
51. The Commission considers that there is no substitutability on the demand-side and insufficient substitutability on the supply-side to justify placing the different services within the one product market. Rather, it considers that analysis of the competitive impact of the acquisition in this case is facilitated by placing the different services provided to the EC in discrete markets.

Geographic Markets

52. The Commission defines the geographic dimension of a market to include all of the relevant spatially dispersed sources of supply to which buyers would turn, whenever competition occurs.
53. In this instance each service is national in scope, and the location of current and potential service providers is not critical to their ability to provide the service. Accordingly, the Commission considers each product market is national in scope.

Temporal Dimension

54. The Commission typically adopts a two year time horizon over which to analyse the likely future competition effects of a proposed merger. However, where a market is characterised by infrequent transactions, the Commission may define a time dimension for the market that deviates from this two year horizon. Time considerations are important where there are long-term contracts, as in the markets considered in this application.
55. Under such winner-takes-all contracting arrangements, competition for the market only occurs at the time of the infrequent contracting rounds, not day-to-day.
56. Typically, the Commission considers the impact of the proposed acquisition at the point in time at which it would have effect, which is when the service provider contracts are put to the market.

Supply of Information to Third Parties

57. When undertaking their functions for the Electricity Commission, EMS, M-co and Transpower collect a range of electricity market data that is of value to industry analysts and modellers. This data includes power flows at grid exit points, generation data, demand data, spot prices, hydrological data, bids and offers, fixed price contracts, and so on.
58. Some of this data is freely available. Other data is available for a fee. The Commission understands that in March 2005 interested parties were notified that grid exit point metering data, which was previously available from EMS for free, would be charged for in future. Some of the interested parties have suggested that EMS is exercising market power in this respect, and that the acquisition may enhance that market power. They suggested that the merged entity might seek to impose charges, or increase charges, for the supply of other data.
59. The Commission recognises that the different types of data are not substitutable one for the other. However, it considers that the issues surrounding access to different data are sufficiently similar for them to be considered within the one market. This approach facilitates the competition analysis without lessening the ability to test whether the acquisition would substantially lessen competition in respect of the supply of this data.
60. The Commission has adopted the name given to this market by one of the parties who made a submission on this issue. That name is the non-regulated electricity data market, and that market is national in scope.

Conclusion on Relevant Markets

61. The Commission considers that for the purposes of this Application, the relevant markets are:
 - The national markets for the provision of the following services in respect of the New Zealand electricity market:
 - Reconciliation Manager (NRM);
 - Pricing Manager;
 - Clearing Manager;
 - Market Administration;
 - Information Systems Manager;
 - Registry; and
 - System Operator.
 - The national market for the supply of non-regulated electricity data.

REASONS FOR THE PROPOSAL

62. In its Application, EMS gave the following reasons for the proposal:
 - 10.1 The acquisition would give EMS greater critical mass and synergies through the bringing together of several market systems which have a natural fit – clearing and settlement is

the next step in the Reconciliation process, creating efficiency benefits and a stronger base for innovation and investment.

10.2 [

].

10.3 [

].

10.4 EMS also believes that it can benefit from the intellectual capital of M-co's employees, especially in relation to the financial operation of markets. In many areas M-co's and EMS' employees' skills are complementary rather than identical due to the historical differences in the focus of the respective firms.

63. However, in several EMS board papers⁷ obtained by the Commission by use of its powers under s 98(a) and (b), Kevin Duckworth, General Manager of EMS stated:

...the rationale for acquiring M-co's New Zealand operations include:

1. [

].

64. Similar comments are made in subsequent EMS documents. In an EMS board paper tabled at the Board's meeting of 14 March 2005, EMS noted the following risk assessment of the takeover and integration of the MO function by EMS/Transpower:

1. [

].

65. Further, the paper summarises the benefits for EMS/Transpower of the acquisition of the Market Operator (MO) functions thus:

⁷ "EMS Strategic Options", 1 December 2004, para 8.6.3. An expanded list first appeared in a Board paper written by Mr Duckworth entitled "Board Paper: Strategic Options – Project Bird", 18 October 2004.

a. [

].

66. Reasons for the acquisition stated in EMS's board papers differ significantly from the reasons stated in EMS's notice seeking clearance. EMS' board papers discuss the extent to which the proposed acquisition would impact on the state of competition for the service provider roles. In particular, the papers state that the rationale for the proposed acquisition [

].

67. The Commission understands that internal papers prepared for the purposes of major projects, such as acquisitions, may tend to exaggerate or advance benefits that are necessary to obtain the approval to proceed. The Commission believes such papers provide a valuable insight into the commercial drivers of acquisition strategies that might not otherwise emerge from the investigation. The Commission is careful not to accept at face value all representations made in such documents, unless they are supported by other information obtained and analysis made from the investigation of the application.

68. At the Commission's request, EMS provided further information in relation to the contents of these board papers⁸. EMS stated inter alia, that [

]. The letter also refers generally to other possible competitors for the MO contracts, and the countervailing power of the EC. The Commission has taken into account the views expressed in this letter.

FACTUAL AND COUNTERFACTUAL

69. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (the counterfactual).⁹ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

⁸ EMS letter dated 8 December 2005.

⁹ *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No 6)*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

The Factual Scenario

70. In the factual scenario, EMS would assume all the service provider functions presently conducted by M-co. Post-acquisition, EMS/Transpower would provide the following services for the remaining duration of the existing contracts:

- Reconciliation Manager;
- Pricing Manager;
- Clearing Manager;
- Information Systems Manager; and
- System Operator.

71. In addition, EMS/Transpower would provide wholesale and retail market administration services to the EC [

].

72. Jade would continue to provide Registry services for the duration of the existing contract and Concept would continue to provide market support and administration services in respect of common quality and security of supply.

The Counterfactual Scenario

73. [

].¹⁰ The Commission recognises, therefore, that all six service provider contracts could be awarded to a single provider at the next tender round whether or not the merger goes ahead (ie in both the factual and counterfactual scenarios).

74. Upon the formation of the EC, M-co lost many of its previous functions in the Electricity Market. To this extent, the Commission considers that absent the acquisition, it has the incentive to bid for the other MO functions that it does not presently perform: the reconciliation manager and the registry.

75. Indeed, Mr Christopher Russell, CE of M-co advised the Commission that in the event that the proposed acquisition did not proceed, M-co would continue to trade and would consider [

].

76. At present it appears that EMS and M-co provide significant competitive tension on one another for the services. Indeed in an EMS Board paper, submitted to the Board at its special meeting on 14 March, 2005, EMS noted:

[

].

¹⁰ Meeting with David Pay, Richard Norris, EC, 27 October 2005.

The Commission considers that this competitive tension would likely continue absent the acquisition.

77. It has been suggested that absent the acquisition M-co might exit the market.¹¹ On balance, however, the Commission regards this as unlikely, at least in advance of the next tender round, as M-co still has a significant investment in IT systems, knowledge and infrastructure and, moreover, remains a profitable going concern. In addition, the Commission considers it likely that M-co would seek to grow its business by bidding for the Reconciliation Manager contract at the next bidding round, and probably at the bidding round after that.
78. Therefore, the Commission considers that the relevant counterfactual for this analysis is the status quo, namely that EMS and M-co continue to operate independently and compete for the EC service provider contracts. Jade and Concept would continue in the roles they currently occupy.

COMPETITION ANALYSIS

79. The Commission has identified a number of issues common to several or all of the relevant markets. These issues are discussed in this section. There then follows further competition analysis for each of the markets individually.
80. The common issues identified are:
- market mechanism;
 - the potential for system integration;
 - countervailing power; and
 - potential bidders.

Market Mechanism

81. In a typical market, where transactions occur (effectively) on a continuous basis, ideas like “entry” and “existing competitors” have conventional meanings. In this case, the Commission has analysed the state of competition at the point at which competition occurs – when the EC requests bids for the next round of contracts for electricity market services. At this point, all providers become “potential competitors” bidding for the provision of the services. Accordingly, in this case the Commission has modified its standard analysis of “existing competition” and “potential competition” and has instead analysed the nature of competition by identifying the likely potential bidders for future contracts, and the extent of competition these bidders would provide in the factual and the counterfactual scenarios.¹²
82. The contests for single-provider contracts mean that competition will be for the market, rather than in the market. In a sense, all of the competition ‘in’ the market

¹¹ d-Cypha, Idea Development Stage “x” Report for Bird, 29 March 2004, p.15, section 6.1.

¹² This approach is consistent with that taken by the Commission in *Decision No.559, New Zealand Diagnostic Group Ltd / Sonic Healthcare (New Zealand) Ltd*; see paragraph 176.

is being compressed into a winner-takes-all ‘for’ the market each time there is a contracting round.

83. It has often been argued in auction theory literature, and before various competition authorities, that in bidding markets (that is, markets when competition is for the market), market share does not correlate to market power, as tends to happen in ‘normal’ markets. Rather, the existence of just two competing players may be enough to ensure competitive outcomes.¹³
84. Paul Klemperer¹⁴ has argued that the competitive outcome result depends on a number of conditions that characterise an ‘idealised’ bidding market, and that where these conditions are not met, the familiar problems of unilateral and co-ordinated effects may arise.
85. The conditions are: competition is winner–take-all, so there is no smooth trade-off between price and quantity; competition is ‘lumpy’ so that in each contest, there is an element of ‘bet your company’; competition begins afresh in each contracting round so there is no ‘lock-in’ or significant advantages from incumbency; entry of new suppliers to the market is easy; and a bidding system is involved.¹⁵
86. The Commission believes that some, but not all, of these conditions hold for the markets for the service provider contracts. In particular, there would appear to be clear incumbency advantages in these markets in terms of sunk investment in systems, detailed knowledge of the industry and track record with the EC. Also, while the contracts are important in financial and/or strategic terms to M-Co and (to a lesser degree) EMS/Transpower (and there is therefore an element of betting the firm), this is less likely to be true for other potential competitors in these markets such as IT houses who have a broader range of alternative sources of revenue.
87. The Commission does not, therefore, consider that these markets can be regarded as pure bidding markets or that a competitive outcome is assured with only two bidders. However, the Commission does recognise that the markets have some of the characteristics of an idealised bidding market and therefore that the number of competitors may be a less significant factor for competition than would be the case in “ordinary” markets. In the light of the above analysis, the Commission regards the key determinant of competition in these markets as whether or not the incumbent faces at least one well matched and aggressive challenger in terms of:
 - having similar costs and facing similar barriers to entry; and
 - having similar incentives to bid aggressively for the contracts.
88. On this view there would be some lessening of competition if, in the counterfactual, EMS and M-co are each other’s strongest competitor in the markets and, in the

¹³ See, for example, S. Bishop, and M. Walker, (2002) *The Economics of EC Competition Law: Concepts, Application, and Measurement*, Chapter 14, Sweet & Maxwell: London; and P. Klemperer, “Bidding Markets”, *Working Paper*, UK Competition Commission, (2005), p.4.

¹⁴ Paul Klemperer is Edgeworth Professor of Economics at Oxford University and a Member of the UK Competition Commission.

¹⁵ For a more detailed discussion see “Bidding Markets” by Paul Klemperer, June 2005, published by the UK Competition Commission.

factual, no third party can be identified as likely to provide a reasonably comparable constraint on the behaviour of the merged entity.

Incumbent Advantage

89. As noted in the discussion of bidding markets, there are some incumbency advantages associated with these roles. These come from, in particular, the fact that the incumbent will have incurred ‘sunk’ costs needed for the necessary systems, will have developed expertise and industry knowledge from experience and will have had the chance to establish a reputation for reliability with the EC. The Commission considers the latter will be important given the strong incentive on the EC to be risk adverse.
90. EMS and M-co are already incumbents in their respective service provider roles and would enjoy these advantages in both the factual and counterfactual scenarios. The question is, would the acquisition somehow increase the incumbent advantage over the next most likely provider of the service. The Commission notes that in those markets where they are not the incumbent, EMS and M-co would have a knowledge and reputational advantage over other firms from their background of providing other services to the EC.

System Integration

91. The Commission is concerned that, if the acquisition were to proceed, the combined entity would be in a position to integrate or bundle the service provider functions in such a way as to make it more difficult either to tender or to contest the functions separately, or in groupings, in future, and therefore that this bundling would lessen the potential for other parties to enter the market. In particular, if the market operation functions, which are currently contestable, were somehow tied to the system operation function, which is not, the contestability of the market operation functions would be reduced.
92. There is some evidence from [
-].
93. [

].¹⁶ To the extent that the integration of the market operation functions and the system operator function increases the risk of higher entry barriers in the future, this is unlikely to occur before the next tender round. However the merged entity may be protected after that time by the higher barriers. Therefore of relevance to the Commission’s analysis is the ability of the EC to set contract terms at the time of the next bidding round which limit the potential for anti-competitive integration.

¹⁶ EMS, “Project Bird Business Case for Transpower Board”, 6 April 2005, p.10.

94. There is evidence to suggest that []¹⁷.
95. The Commission recognises that if the combined entity were able to reorganise its operations to achieve synergies resulting in lower costs, this would represent an increase in productive efficiency. In itself, an increase in efficiency is desirable. However it is not directly relevant to the Commission's considerations under s 66 of the Act. What is relevant is the extent to which the likely structure post-acquisition may inhibit competition for service provider roles.
96. Specific issues about individual systems are addressed in the discussion of each role individually below. In general terms, however, the Commission concludes that:
- Over the medium term there may be scope for integrating or bundling systems such that individual roles become more difficult to tender or contest separately. In particular bundling the MO functions with the SO function would reduce the contestability of the MO and the SO functions resulting in an increase in costs/prices, or decrease in the quality of services to EC.
 - In theory, the EC should be in a position to design the service provider contracts in a way that lessen the possibility of the MO and SO functions being uncontested in the future. Whether or not this is likely to be the case in practice is discussed below.

Countervailing Power

97. In some circumstances the potential for the combined entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition. The Commission has assessed the extent to which the countervailing power of the EC, as the sole purchaser of the individual services, would provide a constraint on the combined EMS/ M-co entity in the factual scenario as compared with in the counterfactual scenario.
98. The EC has not made any firm decisions on the design of the tender process. In principle, however, it is in a position to design the tender process, draft the contracts, and award them so as to:
- allow sufficient time in the process for potential bidders/ new entrants to put together a credible bid;
 - ensure that potential bidders/new entrants have access to key software or provide sufficient lead time for the successful tenderer to build and test the required software;
 - ensure that potential bidders/new entrants have access to the relevant data;
 - ensure that the functions remain separately contestable; and

¹⁷ EMS, "Project Bird Business Case for Transpower Board", 6 April 2005, p.12.

- address the implications of awarding multiple contracts to a single entity, setting the potential for short term efficiency gains against the desirability of keeping several players “alive” to contest future tender rounds.
99. The EC is the sole buyer of the service provider functions and a significant buyer of consulting and other services. Ordinarily, the Commission considers that the countervailing power of a monopsonist purchaser depends largely on the purchaser having a choice of providers. Whether the EC is likely to face a choice of providers in the factual scenario is discussed in detail below for each of the relevant markets individually. However, for all markets this depends in part on the EC’s ability to design the tender process to maximise the chances of receiving competing bids.
100. [
-].
101. If new providers were unable to build and test new systems within six months, this could cause difficulties for any handover from the incumbent supplier to a new provider. The EC advised the Commission that it is aware of this impediment and that it has some way to go before resolving this issue.
102. The EC could, in theory, move the services ‘in house’ if it did not like any of the bids that it received, and this threat could also act as a constraint on bidders. From discussions with the EC, the Commission understands that [
-] Industry participants advised the Commission that they aware that presently the EC has other issues to resolve. To this extent, the Commission does not believe this option is as effective a constraint as a competitive bidding situation.
103. In conclusion, the Commission considers that the EC would be in a position to exercise effective countervailing power only if it faced a choice of providers for the contracts. Whether this is likely to be the case is discussed further for each market separately below. While the Commission recognises that the EC has scope to design the tender process so as to maximise the chances of receiving competing bids, it is also aware that there are unresolved issues surrounding access to software and data, and the tender process itself.
104. The Commission considers that should the EC have a choice of only one credible bidder in the factual scenario, then its ability to leverage its countervailing power by bargaining to reduce price, or requiring future innovations to the requisite IT systems, may be significantly reduced.

Potential Bidders

105. For the bidding markets, the Commission has modified its standard analysis of “existing competition” and “potential competition” and has instead analysed the nature of competition by considering the likely potential bidders for the contracts in

future, and the extent of competition those bidders would be likely to provide under the factual and the counterfactual scenarios.

106. The Applicant submitted that the list of potential competitors in the market as it has defined it (the whole group of administration and data information services) includes:

- The EC itself
- Jade
- Concept Consulting
- Strategen
- TWS Consulting
- LECG
- NGC/Vector
- NZX
- Capgemini (now Hewlett Packard)
- NEMMCO
- Sydney Futures Exchange
- PJM (North American MO and SO)
- Contact Energy
- Unisys
- Logica
- EDS
- Castalia
- PA Consulting
- Charles River Associates
- Accenture
- Synergy International
- The Gas Industry Company Ltd
- Critchlow Associates
- Datacol NZ Ltd
- Energy Direct Ltd

107. The EC has not as yet canvassed the market to gauge the measure of interest in any or all of the proposed contracts.

108. Having contacted a significant number of the organisations listed above, the Commission's view (and that of industry participants) is that the list of firms in a position to submit a credible bid for any one of the service provider contracts is considerably shorter than this, and that the number who might actually choose to bid is probably smaller still.

109. A number of organisations indicated that they were not interested in bidding for the contracts at the next tender round. For example, [

].¹⁸

110. Some organisations did express interest in bidding for some or all of the contracts, providing the terms and conditions were favourable. For example, [] has indicated that it might be interested in bidding for the contracts if it were possible to buy off-the-shelf systems.

¹⁸ Meeting with [

].

111. The EC has not yet launched the tender process for the next round or sought expressions of interest. The Commission recognises that firms may be unable to give a definite indication of intention to bid at this stage and has taken this into account in forming its views of the likely degree of competition at the next tender round.
112. There is evidence to suggest that EMS views the risk of parties other than M-co bidding for and winning these contracts as low. [

]

113. In assessing potential bidders, the Commission has focussed on the following questions with respect to each service provider role:
- Are EMS and M-co both important potential bidders for the role?
 - If so, are there likely to be other credible bidders who would exert competitive constraint on the combined entity in the factual scenario?

COMPETITION ANALYSIS OF SPECIFIC MARKETS

Reconciliation Manager (NRM)

114. The incumbent service provider in this market is EMS.

Entry Conditions

115. The Commission assessed the likelihood and extent to which each potential bidder would likely provide competition in future bidding rounds both with and without the proposed acquisition. In doing so, the Commission consulted widely amongst industry participants and, in the process, identified a number of entry conditions that bidders would be likely to face when attempting to bid for the Reconciliation Manager contract. These entry conditions included:
- software development;
 - technical labour;
 - reputation and prior relationships with the EC; and
 - incumbent advantage.
116. The Commission understands that the EC is in the process of redefining the Reconciliation Manager role and that, as a consequence of this, new software will be required as of the next tender round.¹⁹ In terms of the systems investment needed, therefore, all bidders, including the incumbent, will be in the same position.
117. The Commission understands that it is possible to purchase reconciliation processing systems from international software houses. EMS has estimated that the cost of such a purchase, including the changes needed to adapt the system to the New Zealand market, would be in the range \$[]. EMS has estimated that it could

¹⁹ [].

build a system in-house for \$[].²⁰ The revenue from the Reconciliation Manager contract is of the order of \$2-2.5m per annum.²¹

118. The transition to new software will involve a degree of operational risk for the EC, whether the provider changes or not. However, EMS has demonstrated to the EC that it is able to run a reliable system. In addition, the incumbent would have the advantage of being able to transition between the systems more readily than a new provider.
119. Access to technical expertise was cited by some industry participants as a barrier to entering this market. However, other industry participants, such as Concept Consulting, advised the Commission that such expertise is available both within the electricity industry and in other industries where reconciliation is required (for example securities). The Commission is therefore of the view that technical expertise is unlikely to be a barrier to entry.
120. Other barriers are the less tangible incumbent advantages of detailed familiarity with the New Zealand electricity industry and with the EC itself. Both M-co and Jade enjoy these advantages by virtue of being the incumbents in other service provider roles.

Potential Bidders

121. Whilst the barriers discussed exist under both the factual and counterfactual scenarios, they impact on different market participants to a greater or lesser extent. Owing to differing advantages of information, experience, and resources, some potential bidders may find these barriers insurmountable when attempting to successfully bid for the service provider contracts, whereas others may overcome them more readily.
122. The Reconciliation Manager contract was last tendered competitively in 1998, when it was won by Transpower (which then formed d-Cypha to undertake the role). At that time there were 14 registrations of interest. The Commission understands that Contact Energy bid for the role with Alinta²² ([]²³ but is not aware that any other bids were submitted.
123. In its analysis for Project Bird, EMS prepared a summary of the “key competition” it expected to face for the service provider roles:²⁴

- []
-].

124. []

²⁰ []

²¹ Auditor-General, *The Electricity Commission: Contracting with service providers*, July 2005.

²² Notice Seeking Clearance, p.18, para 16.17.

²³ Meeting with Jim Truesdale, Lee Wilson, 22 November 2005.

²⁴ d-Cypha, “Idea Development Stage “x” Report for Bird”, 29 March 2004, p.15.

] It seems clear from this that EMS regards M-co as its main competitor for this role.

125. In a letter to the Commission dated 22 November 2005, Christopher Russell, CE of M-co, noted that M-co is:

[]

The Commission takes from this that, []

126. The question then is how strong is the competitive threat posed by other organisations. [

].²⁵

127. [

]

128. He added that [

].

129. However, [

].

130. The Commission also notes that [

].

131. [] has indicated more generally that it might be interested in bidding for the service provider contracts if it could purchase off-the-shelf systems. However,

²⁵ Auditor-General, "The Electricity Commission: Contracting with service providers", July 2005.

given the current changes to the Reconciliation Manager role and the requirement for new software, it is not clear whether customisation would be required.

132. In his letter of 22 November 2005, Christopher Russell also advised the Commission that:

[

].

133. In its application, EMS stated that:

[

].

134. This appears to be in contrast with statements in a Board Paper entitled “Strategic Options – Project Bird”, dated 18 October 2004 and authored by Kevin Duckworth. In that paper, Mr Duckworth stated:

[

].

135. The Commission notes that [

]. To this extent, the Commission is less inclined to place weight on PJM as a potential bidder.

Countervailing Power

136. []

137. Whilst the Commission acknowledges the EC is incentivised to promote competition for this service, the EC said that it has not turned its mind to such matters to date. The Commission is of the view that, presently, too many uncertainties exist in respect of the terms and conditions of the future contract for the provision of reconciliation services, particularly in respect of ownership of and access to the requisite data, for the Commission to have confidence that the EC will be able to exercise significant countervailing power in the tender process.

138. The key determinant of countervailing power is having a choice of credible providers. However, without choice between providers (the situation of a monopoly provider versus a monopsony buyer) the countervailing power of the EC, and therefore ability to influence prices, would be significantly weakened. In this situation the purchaser would have no credible alternative supplier to turn to. This is likely to be the scenario under the factual.

139. Accordingly, the Commission cannot, in these circumstances, assume that in the factual the EC would have the same degree of countervailing power that it would likely possess in the counterfactual. Moreover, if Transpower were to begin to

integrate the reconciliation function with its SO function as it has planned, there would likely be a further loss of the EC's countervailing power.

Conclusion

140. EMS regards M-co as its most likely credible challenger for the Reconciliation Manager function under the counterfactual scenario and this view is consistent with the Commission's findings. [] appears to be a weaker potential challenger.
141. The barriers to entry and incumbent advantage in this market are significant but would not necessarily rule out the possibility of other parties entering the market provided the terms and conditions of any contract offered were sufficiently attractive. However the Commission does not have confidence that another strong potential competitor will emerge.
142. Therefore, the Commission considers that in the counterfactual scenario there would be two strong competitors in EMS and M-co, as opposed to the factual scenario where M-co would no longer exist.
143. For this reason, the Commission considers that the EC would have significantly less countervailing power in the factual compared to the counterfactual.
144. To this extent, the Commission considers that post-acquisition, if not at the next bidding round then most likely at the next, EMS would likely have the ability to increase its prices and/or cease innovating its systems such that it gives rise to a drop in quality relative to the likely state in the counterfactual scenario.
145. Accordingly, on balance, the Commission cannot be satisfied that the proposal would not result, or would not be likely to result, in a substantial lessening of competition in the market for reconciliation manager services.

Pricing Manager

146. The incumbent service provider in this market is M-co.

Entry Conditions

147. The Commission understands that there are no dedicated systems required to perform the pricing function²⁶. Capital investment and operational risk associated with switching systems are not, therefore, significant barriers to entry for this role.
148. However, the Pricing Manager is required to set prices using the system operator's scheduling and dispatch data. At present this data is sourced from Transpower's SPD model (scheduling, pricing, dispatch), although the Commission understands that Transpower is developing a replacement for this system.
149. Transpower currently licences SPD to M-co as Pricing Manager. []

There is, therefore, a risk that Transpower could be in a position to deny competitors access to data on the same terms it offers its own subsidiary. While this risk is present in both the factual and counterfactual scenarios, the Commission considers it potentially a more serious risk in the counterfactual. Presently, access

²⁶ Email from Christopher Russell, M-co, 5 December 2005.

to this data will be dependent on the outcome of the EC's negotiations with M-co, Transpower and EMS over resolving the licensing/ownership of software and data in advance of the next tender round.

150. The other potential barrier to entry is lack of expertise in the New Zealand electricity sector and of familiarity with the EC. As previously discussed, the Commission considers this to be a significant factor.
151. As previously discussed, should this function be integrated with the other MO roles as well as the SO role, as is EMS' intent in the factual, the barriers to entry for contracts in the medium to long term could be significantly raised for a potential bidder/new entrant, since entry would then be required to the substantially more complex role of SO as well as to all other MO functions.

Potential Bidders

152. Whilst the barriers discussed exist under both the factual and counterfactual scenarios, they impact on market participants to varying degrees. Owing to asymmetries of information, experience and resources, and familiarity with and track record in the electricity market, some potential bidders may find these barriers insurmountable when considering whether or not to bid for the service provider contracts, whereas others may be able to overcome them more readily.
153. The Pricing Manager contract was last tendered competitively in 1999. The Commission understands that a large number of organisations expressed interest in the role and requested tender documents but that, in the event, only one bid was submitted.
154. In 2003 NZX expressed interest in taking on the Pricing Manager role (as well as Clearing Manager, Information Systems manager, Market administrator, and Registry).²⁷
155. M-co has provided the Commission with a list of the parties it has identified as potential competitors for this role:²⁸

- [
-]

156. [

].²⁹

157. [,
- indicated to the Commission that it would be interested in bidding for this contract,

²⁷ Auditor-General Report.

²⁸ Email from Shane Dinnan, 15 November 2005.

²⁹ Meeting with [].

providing issues such as access to software were resolved properly in the tender documents.³⁰

158. Following discussions with industry participants, the Commission is of the view that given the uncertainty around the likely terms and conditions of any future contract, at this point in time, it is unlikely the parties listed in the high category would compete for this role. To this extent, the Commission is of the view it is even less likely that the second and third tier parties suggested by M-co would be credible bidders for this role.
159. There is some evidence to suggest that EMS is a potential competitor for this role under the counterfactual scenario. The Commission understands that Transpower was one of the organisations that expressed interest in this contract in 1999, although ultimately it did not bid.³¹
160. [

] The

Commission therefore considers that, should the acquisition not proceed, EMS would likely be a strong bidder for the Pricing Manager role, particularly given its relationship with Transpower, which would arguably assist with access to SPD.

161. In addition, EMS has forged a good reputation with the EC in respect of the other roles it performs for the EC. This reputation would likely give EMS an edge over 'untried' bidders.
162. The Commission considers that in the counterfactual, EMS would be the party most likely to provide effective constraint on M-co. The Commission regards [] as weaker potential bidders, particularly after the forthcoming tender rounds. To this extent, the Commission is of the view that it is unlikely in the factual scenario that the combined entity would face realistic competition for this role from another party.

Countervailing Power

163. The Commission considers that in the factual scenario, the ability for the EC to exercise its countervailing power as sole purchaser of this service would be reduced compared to the counterfactual, as it would likely receive a bid only from the combined entity, both in the next and future tender rounds. EMS would likely be aware of the reduction of credible bidders and its bid would likely reflect the reduced competition in terms of either price or quality, compared to the counterfactual. The EC would be unable to leverage any degree of countervailing power because of a lack of credible alternative bidders, and [] as discussed above.

³⁰ Telephone conversation with []

³¹ Email from Robert Thomson, 13 December 2005.

Conclusion

164. The Commission considers that in the counterfactual scenario, if EMS really wanted the Pricing Manager contract (as it seems to indicate that it would, in order to protect its NRM and SO roles), it would likely invest in the necessary expertise to submit a credible bid, and bid aggressively for this contract. However, the Commission considers that in the factual scenario, the merged entity would be unlikely to face competition from a credible bidder. Consequently, the EC would have significantly less countervailing power in the factual compared to the counterfactual.
165. Accordingly, the Commission concludes that, on balance, it cannot be satisfied that the proposal would not result, or would not be likely to result, in a substantial lessening of competition in the market for Pricing Manager services.

Clearing Manager

166. The incumbent service provider in this market is M-co.

Entry Conditions

167. The CHASM (Clearing House and Settlement Management) system is the back-end data warehouse that collects the bids and offers via COMIT and from SPD, SCADA, TPIX and the NRM systems. At each month end, it performs the clearing and settlement function of the market. It is primarily a database that links to all of Transpower's systems via an interface system known as STACS (Staging and Conversion System).
168. M-co has estimated that it would cost about \$[] to build a clearing system such as its own CHASM system, and that there would be annual reinvestment costs of around \$[]. The revenue from the Clearing Manager contract is of the order of \$[]m per annum.³²
169. The Commission understands that clearing systems are not particularly complex but that the challenge for this role would be in ensuring that the system meets the requirements of the electricity market rules.
170. In addition, an alternative provider would require access to the requisite data in order to perform this role. As with the pricing role, there is a risk that, should the acquisition proceed, Transpower would be in a position to deny access to competitors for this role on the same terms it offers its own subsidiary.
171. Again, access to this data will be dependent on the outcome of the EC's negotiations with M-co, Transpower and EMS in resolving the licensing/ownership of software and data in advance of the next tender round.

Potential Bidders

172. The Clearing Manager contract was last tendered competitively in 1999. The Commission understands that a large number of organisations expressed interest in

³² Auditor-General Report.

the role and requested tender documents but that, in the event, only one bid was submitted.³³

173. As noted above, NZX expressed interest in taking on the Clearing Manager role in 2003.³⁴

174. M-co has provided the Commission with a list of the parties they have identified as potential competitors for this role:³⁵

- High: []
- Medium: []
- Low: []

175. [

].

176. As discussed at para 137, the Commission is of the view that given the uncertainty around the likely terms and conditions of any future contract, at this point in time, it is unlikely the parties listed in the high category would compete for this role. To this extent, the Commission is of the view it is even less likely that the second and third tier parties suggested by M-co would be credible bidders for this role.

177. Again, there is some evidence to suggest that EMS is a potential competitor for this role under the counterfactual scenario. As noted above, EMS has analysed this possibility and, although it appears to have been discounted in favour of proceeding with the acquisition, the Commission considers that EMS would be incentivised to compete vigorously in the counterfactual scenario. The Commission therefore considers that, should the acquisition not proceed, EMS would likely be a credible bidder for the Clearing Manager role.

Countervailing Power

178. As previously discussed, the ownership of the data required to perform this role is uncertain.

179. As with the Pricing Manager service, the Commission considers that in the factual scenario, the ability for the EC to exercise its countervailing power as sole purchaser of this service would be reduced compared to the counterfactual, as it would likely receive a bid only from the combined entity, both in the next and in future rounds.

180. In the factual scenario, EMS would likely be aware of the lack of credible bidders and so its bid would likely reflect the reduced competition compared to the counterfactual. The Commission considers that the EC would be unable to exercise

³³ Email from Robert Thomson, 13 December 2005.

³⁴ Auditor-General Report.

³⁵ Email from Shane Dinnan, 15 November 2005.

any significant degree of countervailing power because of a lack of credible alternative bidders, and its [].

181. Furthermore, if Transpower were able to integrate the Clearing Manager function with its system operator role, prior to the EC next tendering the role, then the barriers to entering the provision of this service would increase markedly.

Conclusion

182. In the factual scenario, the Commission is, on the information available, unsure whether another party would bid for the Clearing Manager contract, given the uncertainty of securing a licence for the use of the existing CHASM system, and the cost and lead time required for the development of a new system. However, the Commission considers that in the counterfactual, it is likely EMS would bid for this contract. Under the factual scenario then, the number of potential credible bidders would reduce from two to one.
183. In time, this would significantly reduce the countervailing power of the EC in the factual as compared to the counterfactual scenario.
184. Accordingly, the Commission considers that in respect of the Clearing Manager market, the Commission cannot be satisfied that the acquisition would not give rise to a substantial lessening of competition.

Market Administration

185. Prior to the formation of the EC, M-co was responsible for the governance, administration and operation of the NZEM.
186. Around August 2004, the EC informed M-co that it had reviewed the services provided under the Market Administration contract and that it would not be renewing this contract after 1 December 2004. It also announced that it would be appointing itself as the market administrator but that it would be seeking tenders for the market governance and operational support services in relation to retail and wholesale, transmission, security of supply and common quality.
187. M-co is the incumbent contract holder for the wholesale, retail and transmission workstreams. Concept Consulting is the incumbent for the security of supply and common quality workstreams. The EC commenced these contracts on 1 December 2004 following competitive tenders. The terms of the contracts were initially one year but these have since been rolled over.
188. A condition precedent of the Agreement for Sale and Purchase between EMS and M-co is that M-co, in accordance with its contracts with the EC, would seek consent for the assignment to EMS of its administrative functions from the EC. As EMS is a wholly-owned subsidiary of Transpower, the EC foresaw a potential conflict of interest in respect of the provision by EMS of these services. However, subsequently, the EC granted consent for the assignment, conditional on the following:

- [

].

Entry Conditions

189. The Applicant submitted that the provision of market support services is essentially a secretariat function and does not require any particular software system. Further, EMS stated that there are no real regulatory or frontier costs involved. The EGRs require participants in the electricity industry to register with the EC.³⁶ "Participants" includes those involved in data administration, which is a defined term in the EGRs relating to management of metering data. However, registration is essentially open provided the correct basic information is provided, and so this does not constitute a barrier to entry. The EGRs apply to all participants and are unlikely to act as a barrier to entry to any potential participants.
190. Industry participants advised the Commission, that the expertise and resources necessary to provide the market administration services are readily available and that there is a wide range of firms able to compete to provide the services to the EC.
191. The Commission agrees with the Applicant that barriers to entry to the Market Administrator are low and that the acquisition would not change this situation.

Potential Bidders

192. []³⁷.
193. The Commission understands that when the EC called for tenders for the various Market Support agreements in late 2004, at least six parties submitted tenders. In addition, [] have indicated to the Commission that they would be interested in bidding for all the market administration contracts, and they consider that they could perform these functions with ease.

Countervailing Power

194. Through taking some of the administrative functions in-house, the EC has demonstrated that it has countervailing power in respect of these particular services and that it is prepared to exercise that power.
195. In addition, the Commission notes that there were a number of credible bidders for this role at the last tender round.
196. The Commission considers that this is one function for which the EC would continue to provide countervailing power in the factual, through its ability to absorb easily more of these functions in-house if required, together with its ability to chose between a number of credible bidders.

Conclusion

197. The Commission is of the view that barriers to entering this market are low and that sufficient credible bidders exist. The prospect of Transpower integrating the MO

³⁶ Regulation 9, EGRs

³⁷ Notice Seeking Clearance, para 16.13

and SO functions is unlikely to raise entry barriers in relation to these services. The removal of M-co as a separate bidder in the factual is unlikely to have a significant impact on the future state of competition compared to the counterfactual. In addition, the Commission considers that both in the factual and counterfactual scenarios, the EC would have countervailing power and would likely exercise that power if necessary. Accordingly, the Commission considers that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the market for administration support services.

Information Systems Manager

198. The incumbent service provider in this market is M-co.

Entry Conditions

199. COMIT is the acronym for ‘Commodity Information Trading’, which is M-co’s front-end application used by market participants to enter their bids and offers for electricity dispatch and demand requests. It is a web-based application that collects historical market data created by SPD, SCADA, TPIX and the NRM systems (all owned by Transpower/EMS) and presents this in a user-friendly manner to the market participants. COMIT is therefore a two-way view into the market, presenting historical information as well as enabling participation in forward markets.

200. Amongst other things, COMIT enables users to:

- submit bids and offers to the market;
- obtain pre-dispatch and dispatch signals;
- view forecast, dispatch, five minute (indicative), provisional and final prices;
- access reserve prices and hydrology data; observe island supply and demand levels; and
- receive market summaries and clearing and settlement reports.

201. M-co has estimated that it would cost around \$[] to build a replacement for COMIT, plus approximately \$[] per annum for reinvestment. However, COMIT provides additional functionality above what is required under the service provider contract. M-co receives []. M-co has estimated that a more basic market information system could be built for around \$[].³⁸ The revenue from the Information Systems Manager contract is of the order of \$[] per annum.

202. Presently, the Information System Service Provider Agreement between the Electricity Governance Board (EC) and M-co, dated 22 December 2003, provides that on termination of the agreement, M-co will make COMIT available to any incoming provider of the information system for a period of six months unless another period is agreed by the Commission and M-co.

³⁸ Email from Christopher Russell, M-co, 6 December 2005.

203. Christopher Russell advised the Commission that in the event that M-co lost a future tender for the Information Systems Manager, it would []].
204. However, under the terms of its present contract, it is not obliged to provide COMIT after the expiry of a six month period after termination of the contract. Further, the 14 March 2005 EMS board paper states:
[]].
205. In addition, the EMS board paper states that the build option of IT systems:
[]].
206. To this extent, it is likely that any potential bidder would wish to develop its own information system to perform this role. In order to bid for this role without incurring significant cost (mitigating the risk of losing the contract), a potential bidder would need sufficient lead time to develop and test such a system. Furthermore, the potential bidder would require a contract of sufficient length to justify the significant investment it would have to make in developing a new system.
207. In addition, given the nodal nature of the New Zealand electricity market, the software required to fulfil this role would need to be highly customised. Industry participants considered that they would require a contract of at least five years before they would consider bidding for this role.
208. In the board paper of 14 March 2005,³⁹ EMS noted:
[]].
209. Further, a new entrant would need to have significant credibility with the EC, given that the SO relies on information derived by this information system and that the SO “keeps the lights on.” They would also need to assure the EC that any migration/transition to a new software platform would occur without adverse incident.

³⁹ Page 43

210. The Commission considers that the barriers to entry are likely to be significantly higher for new bidders compared to those for M-co and EMS, particularly given the relationship and reputation that each has forged with the EC in their respective incumbencies.

Potential Bidders

211. Both M-co and EMS enjoy good reputations and relationships with the EC in their respective roles as service providers. In its 14 March board paper, EMS notes that if it were to build a system to compete for the Information System Manager role, it would offer to transition to a new system at no charge to the EC for six months.
212. The Commission considers that those reputations and relationships would make the appointment of M-co or EMS s a more realistic option for the EC compared to that offered by a party as yet untested by the EC.
213. M-co has provided the Commission with a list of the parties they have identified as potential competitors for this role:⁴⁰
- High: []
 - Medium: []
 - Low: []
214. The Commission notes from EMS's board papers that []
-].
215. [] would likely need to find a partner closely acquainted with the New Zealand electricity market to obtain sufficient knowledge to be able to customise sufficiently any system that they might wish to adapt for use in the New Zealand market.
216. [] has indicated more generally that it might be interested in bidding for the service provider contracts if it could purchase off-the-shelf systems. As previously discussed, any such system would require a significant degree of customisation to accommodate the nodal nature of the New Zealand market.
217. When interviewed by the Commission, [] stated that, although it felt it had the reputation required to mitigate any risk of decreased reliability through changing provider that the EC might hold, it considered that the EMS/M-co acquisition would give EMS a big competitive advantage that might deter [] from bidding. [] added that it would not waste money if it thought that it could not win.
218. While these are not insurmountable barriers for these potential bidders, they are not barriers faced by either EMS or M-co and to this extent the incumbents would have an advantage over any bidder 'untested' by the EC.

⁴⁰ Email from Shane Dinnan, M-co, 15 November 2005.

219. The Commission considers that in the factual scenario, the removal of M-co as a potential bidder would reduce the number of likely credible bidders from two in the counterfactual to one in the factual scenario.

Countervailing Power

220. As previously discussed, the EC has yet to decide on a number of relevant factors in respect of the future contract for the provision of the Information Systems Manager role. First, there is uncertainty surrounding the ownership of proprietary rights of the software involved and resultant data. Secondly, it has yet to determine the length of any proposed contract, which may affect the likelihood of another party bidding against the combined entity for this role.
221. If the EC did not receive a competing bid in the factual scenario, the EC's bargaining position would be reduced for two reasons. Firstly, it would not have a competing bid against which to benchmark. Secondly, as this is a vital service for the functioning of the New Zealand electricity market, and given the barriers faced by other potential bidders including the lead time required to develop and test a system, the EC is unlikely to threaten credibly EMS with the loss of the contract.
222. Furthermore, in the factual scenario, with no credible competition, EMS would not have the incentive to update and innovate the system which could result in a reduction in quality compared to the factual scenario.
223. In its 14 March board paper, EMS states that:

[

].

224. The Commission concludes that compared to the counterfactual, the countervailing power of the EC is likely to be significantly lessened in the factual scenario.

Conclusion

225. Accordingly, the Commission is of the view that the proposal would reduce the number of likely credible potential bidders for the Information Systems Manager contract from two to one. This in turn would lessen significantly the EC's countervailing power in the factual as compared to the counterfactual scenario. Accordingly, the Commission cannot be satisfied that the proposed merger will not have, or would not be likely to have, the effect of substantially lessening competition in the Information System Manager market.

Registry

226. The incumbent service provider in this market is Jade.

Entry Conditions

227. The Registry function was first tendered in 1999, when Jade won. Any winner would, therefore, have been a new entrant to the specific function. It is worth

noting however, that Jade did not have previous experience in the electricity industry in New Zealand.

228. This precedent suggests that familiarity with the electricity industry in New Zealand is not a pre-requisite for undertaking this role and is not, therefore, a barrier to entry to this market.
229. However, once an operation has been established, there may be a significant incumbent advantage in terms of having a Registry system already up and running. This would be the case in both the factual and counterfactual scenarios.
230. The Commission understands that in the formative days of the present registry, Jade experienced significant difficulties importing into the registry database the metering data that it was provided. However, the Commission understands that these issues have now been rectified, albeit at a considerable cost to Jade.
231. Industry participants advised the Commission that the registry role is one of the more straightforward roles to perform, particularly for software companies specialising in databases.

Potential Bidders

232. In the counterfactual both M-co and EMS are potential competitors for this role. Other competitors could include national and international software providers that specialise in the provision of database services. M-co advised the Commission that Jade's bid for the registry function "came out of the blue".
233. In the factual scenario, although M-co would no longer pose a competitive threat, EMS would remain as a credible competitive alternative to Jade. In addition, given the view of industry participants that Jade's registry would be relatively straightforward to provide, the Commission considers it likely that, as when Jade first tendered for and won the registry contract, an entirely new bidder could compete for the registry contract in both the factual and the counterfactual scenarios.

Countervailing Power

234. In contrast to the pricing, clearing, reconciliation and information systems functions, the Commission considers that in the factual scenario, the loss of M-co as a potential bidder for the registry contract would not significantly reduce the countervailing power of the EC. This is because it would likely have EMS as a potential bidder, together with the ability to benchmark the cost of such service provision from providers of registry systems in other industries.

Conclusion

235. If the acquisition proceeded, Jade would face one fewer potential competitors than in the counterfactual, but the combined entity would itself provide competitive constraint on Jade. Furthermore, the barriers to carrying out this function are not so high as to preclude other developers of databases and registry systems from submitting credible bids for the performance of this function, either in the proposed 2006 tender round or in future rounds.

236. Therefore, the Commission concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the market for the Registry services.

System Operator

237. The incumbent service provider in this market is Transpower.

Contestability

238. The EGRs require Transpower to be appointed as System Operator. Transpower has access to M-co's COMIT system, which enables it to perform this function.

239. Presently, the EC cannot tender this contract competitively unless it can persuade the Ministry of Economic Development to agree to a change in the EGRs. Even if it did this, it could not offer the tender until after the end of the current contract (2009). [

].⁴¹

240. Consistent with EMS/Transpower's views, the Commission considers that the future of the System Operator role will be determined in greater part by government policy, in particular whether or not the EC chooses to adopt an Independent System Operator model, than by competitive dynamics among potential service providers. In any case, the System Operator contract is not contestable until 2009 at the earliest.

241. The Commission considers that a key part of the rationale for the acquisition is the suggestion that it will help Transpower defend the System Operator contract over the longer term. EMS/Transpower has stated that [

].⁴²

242. [

].

243. This suggests that [] consider there is a real possibility that the SO role will become contestable in the future, and the Commission agrees with this view. The Commission cannot ignore the possibility of this service becoming contestable in 2009, and therefore should assess the likely competitive effect the proposed acquisition will have on this market.

Entry Conditions

244. The barriers to entry to this market are significant, both in terms of the investment and expertise needed, and also, from the EC's perspective, the operational risk of switching provider.

245. Les Hosking CEO of NEMMCO advised the Commission:

⁴¹ Telephone conversation with Roy Hemmingway, EC, 29 November 2005.

⁴² EMS, "Agenda for Special Board Meeting of Directors", 14 March 2005, p.1.

It {the cost of entering the SO role} would have to be fairly significant you'd have to meet your start-up costs within a short space of time, the other cost is you'd have to have a reasonable period of time in which to operate. You'd have to have a couple of year's notice and you'd have to have a guarantee that you're there for ten years to cover your costs.

I would hate to have to introduce a new MSATS system in Australia – it would be painful and there's also reputational risk.

NEMMCO believes it has the best of the best staff, we cherry pick them from all of the States but I would not be confident taking those people across to NZ and setting up the NZ market because of the way the NZ market operates. We had to be taught by the Tasmanians how to operate the Tasmanian market. So if you're going in there and trying to compete, you'd have to ask how to do it before you could. It's the reliability, it's the constraint formulas, it's everything involved in keeping the pressure up on the system. You would need an intellectual capital that would take years to build.

246. When asked whether the consolidation of the MO and SO functions would raise barriers to entering this function, Les Hosking of NEMMCO advised the Commission:

It's got to - it's got to raise the barriers to entry. To replicate that entrenched entity would be doubly difficult – you wouldn't do it in that {New Zealand} market. To have the incentive to go into that market, you would have to be a consortium of businesses that was so disgruntled with the service that you had to go and do it yourself. And that threat might be the balance to bring the entrenched entity back into line.

247. However, the Commission notes that in the New Zealand market, the Electricity Industry Reform Act 1998 would preclude electricity supply companies from operating the transmission network.

Potential Bidders

248. The Commission is not aware of any other firm that is considering tendering for the System Operator role at this stage, in large part because it is not clear whether the function will be contestable in the future.
249. It is likely that in the counterfactual scenario, were the System Operator contract to become contestable, M-co would be a bidder. M-co advised the Commission that in the counterfactual it would [

]. The Commission notes that M-co's parent company, MIL, is involved in the provision of market design and administration services to electricity markets in other jurisdictions. MIL's activities include:

- a joint venture with the Singapore Government to set up and implement the wholesale electricity market in Singapore;
- designing the South African wholesale electricity market; and
- designing Taiwan's independent system operator for its electricity market.

250. In addition, Transpower views M-co as a potential competitor for the SO role when it becomes contestable. Kevin Duckworth noted in an EMS Board paper⁴³ that [].
251. The EMS board paper submitted at the 14 March 2005 meeting states that, taking a ten year view, the probability of Transpower retaining the SO function in a “do nothing” scenario is []%, compared to []% in the factual. This would indicate that Transpower considers that it does face competition for the SO role, and indeed that it considers the role will, at some point in the next 10 years, become contestable.
252. Further the paper states:
[]
253. The Applicant submitted that the presence of M-co’s parent company, MIL, in other international markets denotes the global nature of electricity markets, and the possibility that competitors are located internationally. However, the Commission notes that each of these ventures is in emerging rather than established markets.
254. Further, as noted, EMS does not consider it likely that PJM will enter the New Zealand market because of the distance from its core operations as well as a perceived lack of scale.
255. The Commission considers that in the factual scenario, Transpower, as per its stated intent, is likely to integrate all of the MO functions with its SO function, if not by the 2006 tender round, then by the following tender round.

Countervailing Power

256. Roy Hemmingway, Chair, EC, advised the Commission⁴⁴ that integrating the services could raise barriers to entering the MO functions:

If you were to somehow integrate the software in a way that it couldn’t be pulled apart then you would end up being in a situation where you had to make them contestable as one piece and as I said it is much more difficult to make the Systems Operator contestable.

We have not drawn a conclusion that we can do that as much as we would like because Transpower owns the control centres and the trained personnel work for Transpower and this thing has to operate in real time and the hand-over is pretty critical, if we were to give it to another provider. We haven’t given it a lot of thought on how that might be done but suffice as it is to say that I think everyone acknowledges it is difficult to make the Systems Operator contract contestable in comparison to the market operations contracts and if they were somehow integrated such that we couldn’t pull them apart the fact that the Systems Operator contract more difficult to be made contestable would mean we would end up with the market contracts being more difficult to make contestable.

I think they could be integrated I think we did think about that. Maybe if Reconciliation was more integrated with the Pricing and Clearing Manager that wouldn’t be a bad thing. And so,

⁴³ Board Paper: “Strategic Options – Project Bird”, 18 October 2004, p.4

⁴⁴ Telephone conversation with Roy Hemmingway, EC, 29 November 2005.

having EMS have control of those things might be alright but the idea that they might be integrated with the Systems Operations, I must confess it's an alarming thought.

257. In addition, the Commission considers that given EMS/Transpower's previously stated reasons for wanting to integrate the MO and SO functions, it appears that Transpower considers the SO role will likely be contestable in 2009.

Conclusion

258. The Commission cannot ignore the fact that Transpower views M-co as the main competition to the System Operator role, in the medium to long term. In addition, the Commission considers it unlikely that other potential bidders would emerge to contest this role in 2009. Furthermore, if EMS and Transpower are able to integrate some or all of the MO functions with the SO functions, then the Commission considers the barriers to entering either the SO or MO roles would be increased significantly. The Commission therefore concludes that it cannot be satisfied that the acquisition will not or would not be likely to result in a substantial lessening of competition in the market for System Operator service provision.

The Market for the Supply of Non-Regulated Electricity Data

Background

259. In the course of providing their respective services, EMS, Transpower and M-co gather a considerable amount of data relating to electricity trading. This data can also be valuable to other parties in the sector.
260. The data includes nodal prices, bids, offers, prices for reserve electricity and so on. Much of this information is freely available in time, but there is a market for this information if the supplier can add value to it – possibly by placing it in suitable packages and providing these packages in a timely manner.
261. The Commission has considered whether the proposed acquisition would be likely to result in a substantial lessening of competition in the market for the supply of this information.

Competitive Impact of Acquisition

262. M-co, EMS and Transpower have different but related functions, and in undertaking their functions collect and/or utilise industry data.
263. M-co is the provider of COMIT under contract to the EC, and this system stores and conveys a range of electricity market data.
264. TPIX (Transpower Information Exchange) was developed by Transpower in the earliest days of the electricity market, and is a computer system containing a range of wholesale market and reserves market information.
265. EMS, as Reconciliation Manager, obtains early access to meter information at each GXP. This information is used in the reconciliation process and is supplied to other parties for their analysis of electricity demand and as an input for electricity modelling. [] has suggested to the EC⁴⁵ that much of this data should be

⁴⁵[].

made available to third parties on reasonable terms and conditions. This data includes:

- GXP Global data;
- retailers' reconciled GXP off-take data;
- generation injection data;
- Transpower's demand and generation SCADA data;
- total settlements – sales and purchases – in the spot market;
- losses and constraints surplus data including total wash-ups;
- nodal prices at all market nodes;
- reserve prices; and
- risk offsets.

266. The basis of concerns expressed to the EC about the future availability of this data is that the supplier has the potential to charge higher prices for the data than would be possible if the data market were competitive.
267. In the main the parties to the acquisition make different data available to the data market. Nevertheless there is some overlap. For instance, nodal prices and reserve prices are available both from TPIX (Transpower) and from COMIT (M-co).
268. However, the Commission notes that the data invariably derives from only one source. For instance, some data is gathered by EMS (or Transpower) for use in TPIX, but EMS also makes it available to M-co, which in turn uses it in COMIT. Thus, other users might perceive there to be currently two sources of the data – TPIX and COMIT.
269. In practice, however, market power (if it exists) would normally lie just with the originator of the data – in this example EMS. If it is possible to charge supra-competitive prices for the data, EMS may choose to exercise that power. That might cause the Commission under Part 4 of the Act, or the EC, to respond in some way. However, the Commission considers that the ability for the providers of this information to charge supra-competitive prices exists in both the factual and the counterfactual scenarios.
270. Indeed, the Commission notes that several market participants have already laid complaints with the EC in respect of the prices that EMS/ Transpower are charging presently for this data. The Commission understands that the EC is exploring its options in respect of this situation. The EC advised the Commission that given the uncertainty around the IP associated with the relevant software and data, it is at this point unsure of what it can do to resolve the situation. This situation further illustrates the issues the EC faces in respect of its countervailing power in the factual scenario.

Conclusion

271. The Commission considers that the present pricing issues surrounding access to non-regulated electricity data is one that would exist in the counterfactual as well as the factual scenario.
272. Accordingly, the Commission considers that compared to the counterfactual, the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the market for the supply of non-regulated electricity data.

OVERALL CONCLUSION

273. The Commission concludes that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the markets for the provision of the following services allied to the New Zealand Electricity Market:
- Market Administration;
 - Registry; and
 - Non-regulated electricity data.
274. In the remaining markets, the Commission concludes that the proposed acquisition would reduce the number of likely potential bidders from two strong potential competitors in the counterfactual, to one in the factual. For this reason, the Commission considers that the EC would have significantly less countervailing power in the factual compared to the counterfactual.
275. In addition, the Commission cannot be satisfied that the acquisition would not enhance the ability of EMS to combine all of the services with Transpower's System Operator function in such a way as to raise substantially, the barriers to entering any or all of the MO functions.
276. Further, the Commission concurs with EMS view that by integrating the SO and MO functions, EMS could significantly reduce the contestability of the SO role in future.
277. For these reasons, the Commission cannot be satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in:
- The national markets for the provision of the following services allied to the New Zealand Electricity Market:
 - Reconciliation Manager;
 - Pricing Manager;
 - Clearing Manager;
 - Information Systems Manager; and
 - System Operator.

DETERMINATION ON NOTICE OF CLEARANCE

278. Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline clearance for the proposed acquisition by Energy Market Services Ltd of all of the shares of The Marketplace Company Ltd.

Dated this 20th day of December 2005

Paula Rebstock
Chair
Commerce Commission