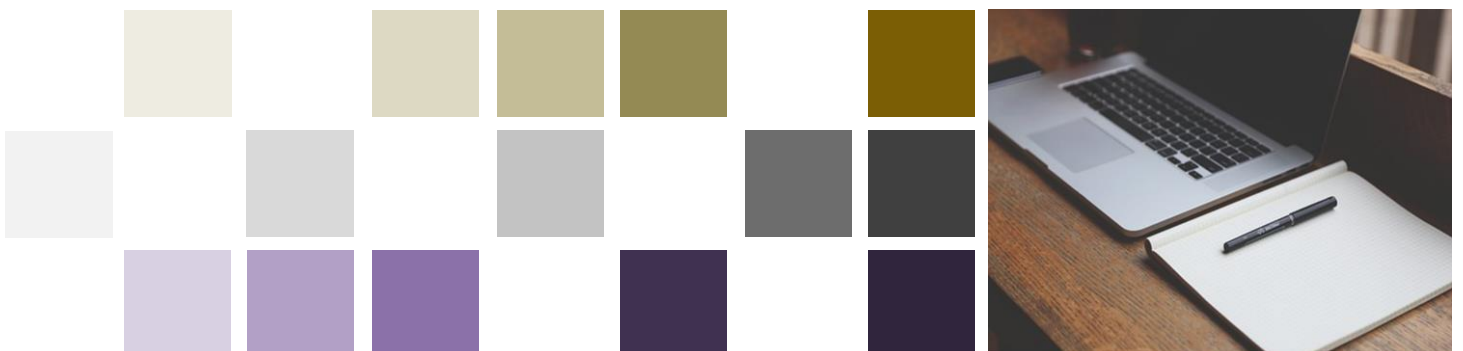


Mercury NZ Limited acquisition of retail operation of Trustpower Limited

Report prepared for Chapman Tripp

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Contents

About the authors.....	iii
Executive summary	iv
Introduction.....	8
The parties and the proposed transaction.....	9
The parties.....	9
The transaction.....	11
Activities impacted by the proposal.....	11
Relevant markets.....	13
Defining a market for competition analysis.....	13
Electricity, natural gas, LPG, and broadband are separate product markets.....	13
Functional and geographic markets.....	15
Temporal and customer dimensions.....	23
Conclusion on markets.....	23
Competition assessment.....	24
Counterfactual.....	24
Competition effects in retail market for electricity.....	28
Competition effects in retail market for gas.....	37
The wholesale electricity market (including electricity derivatives and ancillary services).....	39
Retail market for telecommunications services.....	41
Bundling.....	42
Conclusion.....	44
References.....	46
About Sapere.....	49

Tables

Table 1 Activities of Mercury and Trustpower.....	11
Table 2 GXPs where combined entity would serve 45 per cent or more of ICPs as at May 2021.....	31
Table 3 Gas gates where combined market share of Mercury and Trustpower exceeds 50 per cent.....	39

Figures

Figure 1 Percentage of total electricity consumption by sector – year to March 2021	16
Figure 2 Residential and SME retailer market shares by ICP number as at 30 June 2021	17
Figure 3 Market shares by retailer, 2004 to 2021	18
Figure 4 Switching activity, rolling 12 month as a percentage of all ICPs, 2004 to 2021	18
Figure 5 Retailer ICP share by region – June 2021	20
Figure 6 Annual switching rates between January 2018 – May 2021	21
Figure 7 Fixed-line broadband connections by technology.....	27
Figure 8 Market share (measured by ICP) – 2011-2021.....	29
Figure 9 Market share of small retailers – 2011-2021	29
Figure 11 West Coast transmission schematic	32
Figure 11 Central North Island transmission schematic	34

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Executive summary

1. Mercury NZ Limited (Mercury) has reached an agreement with Trustpower Limited (Trustpower) to acquire Trustpower's mass-market retail operations for electricity, gas, fixed and wireless broadband, and mobile phone services, as described in Mercury's Clearance Application, dated 30 July 2021. The acquisition would bring together Mercury's and Trustpower's activities in relation to mass-market customers for retailing:
 - electricity
 - reticulated gas
 - LPG bottled gas
 - fixed and wireless broadband
 - mobile phone services
2. Mercury would also acquire a small number of commercial and industrial gas customers.
3. As Mercury does not currently undertake bottled LPG and mobile phone services, the acquisition would not lead to any aggregation in retailing of these activities. Our report considers the potential competition effects of the acquisition in the electricity, reticulated gas, and broadband markets.
4. For the reasons developed in our report, we consider the following markets are relevant for the analysis of the competitive effects of the proposed acquisition:
 - the national market for retailing electricity to mass-market customers
 - the North Island market for retailing reticulated gas to mass-market customers
 - the national market for retailing broadband to mass-market customers.
5. For completeness, we assess whether the acquisition would have any competitive effects in the national wholesale electricity market, including on the supply of derivatives and ancillary services if these are separate markets. We also consider the competitive effects if any of the markets are limited temporally or geographically.
6. In our analysis we adopt a counterfactual scenario whereby, absent the transaction, Trustpower would retain its mass-market retailing business as:
 - this scenario would involve no aggregation in the relevant retail mass-markets, and therefore a conclusion that the acquisition would not result in a substantial lessening of competition relative to that scenario should also hold relative to other plausible scenarios (such as a sale to other entities)
 - it has the benefit of being the status quo, and therefore observable.
7. Prior to the transaction, the retail electricity market is characterised by five large retailers and around 30 other competing retailers of various sizes and longevities. Post-transaction, Mercury would have a retail market share of 26.9 per cent based on installation control point (ICP) numbers. Its two largest competitors would be Genesis with 22.2 per cent and Contact with 19.3 per cent market shares. Hence, post-transaction, the national market share of the three largest

retailers, measured by number of ICPs, would be 68.4 per cent. These post-transaction market shares would be within the Commission's market share and concentration indicators.

8. We consider that the competitive landscape of the New Zealand electricity retail market is characterised by multiple competitors, ease of entry, high levels of customer switching between competing retailers, and ongoing implementation of regulatory initiatives by the Electricity Authority to support small retailers and consumer switching. This competitive landscape means Mercury, post-acquisition, would not be able to profitably sustain a SSNIP. That is, the acquisition by Mercury of Trustpower's mass-market electricity retail business would not substantially lessen competition in the national market for retailing electricity to mass-market customers.
9. We consider separately the Grid Exit Points (GXPs) where the combined share of ICPs served by Mercury post transaction at those GXPs would be close to 50 per cent or more. We separate out these locations for further analysis to assess whether there are any transmission limits or other constraints that might reduce competition at these locations relative to the competitive pressure being experienced in the national retail market.¹ The four regions where those GXPs are found are:
 - West Coast of the South Island
 - King Country
 - Bay of Plenty
 - Auckland.
10. The transaction is likely to be pro-competitive for retail customers on the West Coast as it will ameliorate the current situation where a retailer wishing to compete with Trustpower's retail offer on the West Coast may need to contract with Trustpower (as a generator) if the retailer wishes to cover locational price risk (due to weaknesses in the transmission grid). Mercury will not have a direct supply advantage on the West Coast. The hedge arrangements in the proposed deal transact at a Financial Transmission Rights (FTR) node, and hence other retailers can access liquid exchange traded instruments at that same node.
11. King Country Energy previously supplied a high proportion of retail customers in the King Country. That proportion began to fall once the Electricity Authority initiated policies to promote retail competition in 2009, and it has continued to fall since Trustpower acquired the King Country Energy retail business. Mercury currently ranks a distant fifth in the region. There

¹ We note that the Electricity Authority adopts varying regional boundaries when reporting on retail competition. It sometimes uses a breakdown by regional council, (Electricity Authority, 2018). It also publishes data aggregated by distribution networks as they existed in 2003 (<https://www.emi.ea.govt.nz/Retail/Datasets/MarketStructure>). We were not able to locate an explanation for why the Authority uses these regional decompositions, but they do not appear to result from considering whether retail services are substitutable (the test in competition economics for defining a market boundary). For example, the Authority's categorisation would have customers in New Lynn being in a separate geographical market from Avondale, and we see no economic basis for that distinction.

are no transmission issues that might set back the demonstrated entry of retailers into the region or separate the area from the competitive national retail electricity market.

12. There are no physical constraints of any significance that impede competing retailers from entering or expanding their share of customers in the Bay of Plenty. The acquisition of Trustpower's mass-market electricity retail business is therefore unlikely to substantially lessen competition in the Bay of Plenty.
13. Trustpower's customers in Tauranga and the Western Bay of Plenty region have to date received a rebate from the Tauranga Energy Consumer Trust (TECT). The TECT is proceeding with a restructure that will mean Trustpower customers as at 28 January 2021 will continue to receive the rebate if they remain with Trustpower or with the entity that acquires Trustpower's retail business (in this case, Mercury).² The rebate will not be available to Mercury's existing customers, nor to any new customers, whether the customer is acquired by Trustpower or by Mercury. As the entitlement to the rebate is not changed by the transaction, any competitive effects of the rebate are not altered by the transaction.
14. Mercury currently serves about 41 – 42 per cent of the ICPs supplied by the Mangere and Pakuranga GXPs. Trustpower serves about 6 to 7 per cent, so post the transaction Mercury will serve about 48 per cent of the ICPs supplied through these GXPs.
15. There are no transmission issues that might separate Auckland GXPs from the competitive national retail electricity market. As discussed above, the transaction will not substantially lessen competition in the national electricity market, nor in any narrowly-defined Auckland area where retail customers have a choice of around 30 retailers.
16. The North Island retail gas market is characterised by six gas retailers present in each of the gas subsystems, with other smaller retailers also serving customers connected to some networks. Post transaction, Genesis would remain the largest retailer with 34.9 per cent of the market by ICP. Mercury would be second largest, with a market share by ICP of 27.1 per cent, followed by Contact with 21.8 per cent. Hence, post-transaction, the national market share of the three largest retailers, measured by number of ICPs, would be 83.8 per cent, and therefore outside the Commission's market concentration indicator.
17. Given the number of retailers in the North Island retail gas market, switching levels, and the entry and growth of new competitors in recent years, we conclude that the market is competitive and that barriers to entry are low. The acquisition by Mercury of Trustpower's mass market retail customers (and a few commercial and industrial customers) would not result in a substantial lessening of competition in the North Island market for retailing reticulated gas to mass-market customers.
18. There are five gas gates where the combined share of Mercury and Trustpower's retail base would exceed 50 per cent. All of these gas gates are located in Tauranga and the Western Bay of Plenty. There are no physical characteristics of gas supply at these gates which would

² We are instructed that the restructure of the TECT will proceed regardless of the transaction between Mercury and Trustpower.

distinguish them competitively from gas gates elsewhere in the North Island market for retailing reticulated gas.

19. For completeness, we considered any potential impact in the wholesale electricity and gas markets. We conclude that the size of the initial change in risk profile of each entity in the wholesale markets is not sufficient to change the behaviour of either party in the wholesale electricity, electricity derivatives, ancillary services or wholesale gas markets.
20. The transaction would aggregate Trustpower's 109,000 broadband, fixed line and mobile customers with the 20,000 customers served by Mercury's NOW New Zealand (assuming Now New Zealand is associated with Mercury). This aggregation could not result in a substantial lessening of competition in the residential broadband market as the aggregated market share is too small. Mercury would compete in the national broadband market against well-resourced and established entities.
21. Trustpower currently offers its mass-market retail customers the option of purchasing a bundle of its electricity, gas and broadband services. Mercury has indicated that it intends to retain existing bundling arrangements for Trustpower customers and extend similar bundling arrangements to existing and new Mercury customers. The circumstances described by the Commission in which bundling could result in competitive harm would not arise in any bundling by Mercury post its acquisition of Trustpower's mass-market retail business. Mercury does not have market power in any relevant retail market that it could leverage into another market by bundling services.
22. In short, we conclude that Mercury's acquisition of Trustpower's mass-market electricity, gas, fixed and wireless broadband, and mobile phone services retail operations would not result in a substantial lessening of competition in any market. The transaction may result in increased competition in electricity retailing on the West Coast.

Introduction

23. Mercury NZ Limited (Mercury) has reached an agreement with Trustpower Limited (Trustpower) to acquire Trustpower's mass-market electricity, gas, fixed and wireless broadband, and mobile phone services retail operations, as described in Mercury's Clearance Application, dated 30 July 2021. For ease of reference, we refer to both Mercury and Trustpower as 'the parties'. In addition, the parties will enter into a hedge agreement that will enable Mercury to hedge financial risk in the wholesale market for specified quantities of wholesale purchases until 2031.
24. We understand that the agreement is subject to regulatory approvals. This report provides an economic assessment of the competitive effects of the proposed acquisition.
25. We structure our report into four sections as follows:
 - our understanding of the existing activities of the parties, and the activities that would be acquired by Mercury
 - definition of the relevant markets
 - an assessment of the likely effect on competition in each market
 - our final section sets out our conclusions.

The parties and the proposed transaction

The parties

Mercury NZ Limited

26. Mercury is New Zealand's fourth largest electricity generator by capacity, the third largest electricity retailer, and the third largest gas retailer on the basis of customer numbers. It has 1,416MW of generating capacity.³ Total generation in 2019/20 was 6,327 GWh (Mercury, 2020, p. 45).
27. Mercury operates nine hydro stations on the Waikato River with a combined capacity of 1,052MW. Its geothermal portfolio consists of Kawerau (106 MW), Rotokawa (38 MW) and Ngatamariki (85 MW), a joint venture with Tauhara North No. 2 Trust at Nga Awa Purua (136 MW), and a 25 per cent interest in Mokai (113 MW). In 2019/20, Mercury generated 2,615 GWh from its geothermal portfolio and 3,712 GWh from its hydro portfolio.
28. Mercury retails under the Mercury and Globug brands. At 30 June 2021, Mercury had a total of 326,206 electricity customers, 15.1 per cent of all connections.⁴ As of May 2021, Mercury serviced 44,961 gas customers, which represents 15.1 per cent of all connections.⁵ A sizeable proportion of gas customers are likely to purchase both their electricity and gas from Mercury.
29. Mercury does not retail bottled LPG (Mercury, 2021).

Associated persons

30. For the purposes of the substantial lessening of competition test in the context of a merger or acquisition, "a person includes two or more persons that are interconnected or associated".⁶
31. Most of Mercury's activities are structured as business units or subsidiaries and as such are interconnected for the purposes of competition analysis. In our analysis, we assume:
 - a) Mercury is associated with NOW New Zealand Limited as it holds almost 49 per cent shareholding;⁷ NOW New Zealand is based in Hawke's Bay and provides broadband services to approximately 20,000 customers.
 - b) Mercury is associated with Ngatamariki, Rotokawa and Nga Awa Purua. Although the geothermal steamfield plant, and in one case the power station, are jointly owned with the Tauhara North No. 2 Trust, Mercury has an equal share in the geothermal steamfield plant, a

³ The Mokai Geothermal station, in which Mercury has a 25 per cent share, is excluded from this total.

⁴ Electricity Market Information (EMI) website www.emi.ea.govt.nz

⁵ <https://www.gasindustry.co.nz/work-programmes/switching-and-registry/current-arrangements/reports/>

⁶ Commerce Act 1986, section 47(2).

⁷ Trading as NOW Phone and Broadband, Industry Classification: J591020 Internet service provider; see <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1221330>

65 per cent interest in Nga Awa Purua power station and is outright owner of Ngatamariki and Rotokawa power stations. Mercury operates the power stations and the geothermal steamfield assets (Tauhara North No. 2 Trust, 2021).

- c) Mercury is associated with the Mokai power station. The Mokai power station is owned by the Tuaropaki Power Company, which is 25 per cent owned by Mercury and 75 per cent owned by the Tuaropaki Trust. Mercury operates the power station and steamfield assets.⁸

Trustpower Limited

- 32. Trustpower is the fifth largest electricity generator by capacity in New Zealand (Electricity Authority, 2018). In the year ended March 2021, Trustpower generated 1,708 GWh from its generation portfolio of 498 MW (Trustpower, 2021).
- 33. Trustpower operates a total of 38 hydro power stations grouped in 19 power schemes across the North and South Islands (Trustpower, 2021). The largest generating capacity of these schemes is from the four stations of the Waipori scheme in Otago with a total capacity of 83 MW. However, the Matahina scheme on the Rangitaiki River in the Bay of Plenty has a higher estimated productivity of 290 GWh, compared to 192 GWh of the Waipori scheme. Trustpower also operates a diesel peaker at Bream Bay with a capacity of 9 MW.
- 34. Trustpower retails under the Trustpower brand. At 30 June 2021, Trustpower had a total of 253,866 electricity customers, 11.8 per cent of all connections. As of May 2021, Trustpower serviced 35,509 gas customers, which represents 12.0 per cent of all gas connections. Trustpower also retails LPG bottled gas.
- 35. Trustpower provides wireless services (broadband and wireless) and telephone services. In the year to 31 March 2021, Trustpower earned \$105m in revenue from its telecommunications services (Trustpower, 2021).

Associated persons

- 36. Like Mercury, most of Trustpower's activities are structured as business units or subsidiaries and as such are associated for the purposes of competition analysis. In our analysis, we assume:
 - a) Trustpower is associated with King Country Energy Limited (KCE), given it has 75 per cent ownership of KCE and KCE has contracted Trustpower to operate and maintain its generation assets.
 - b) Trustpower is associated with Vodafone New Zealand Limited (Vodafone) through the common ownership by Infratil New Zealand Limited, which has a 51 per cent stake in Trustpower and a 49.9 per cent shareholding of Vodafone.

⁸ <https://www.energynews.co.nz/resource/geothermal-power-station/1023/mokai>

The transaction

37. We are advised that Mercury proposes to acquire Trustpower’s mass retail market electricity, gas, fixed and wireless broadband, and mobile phone services. We understand the phrase ‘mass-market customers’ to include residential and small commercial customers but exclude wholesale commercial customers (except Mercury will acquire a small number of commercial and industrial gas customers).
38. The acquisition would see Mercury acquire the following Trustpower retail assets:
- Trustpower’s retail contracts covering (based on the most recent ICP data) approximately:
 - 254,000 retail and small commercial electricity ICPs^{9, 10}
 - 112,000 telecommunication customers (fibre broadband, fixed wireless, voice and mobile retail offerings) (Trustpower, 2021)
 - 44,000 gas connections (of which, about 35,500 are North Island reticulated gas customers with the remainder bottled LPG users) (Trustpower, 2021).
 - Trustpower’s retail’s branding, IT systems, office leases in Tauranga and Oamaru used to sell and service those utility offerings to retail customers.
39. As part of the acquisition, Mercury would enter 10-year wholesale electricity hedge arrangements with Trustpower. These hedge arrangements [].

Activities impacted by the proposal

40. Table 1 summarises the existing activities of Mercury and Trustpower and identifies those activities that would be acquired by Mercury.

Table 1 Activities of Mercury and Trustpower

Activity	Mercury	Trustpower	To be acquired by Mercury
Electricity			
Generation	Yes	Yes	No
Transmission	No	No	No
Distribution	No	No	No

⁹ An ICP is a physical point of connection on a network that the distributor nominates as the point at which a retailer is deemed to supply gas or electricity to a consumer. We measure market share by number of ICPs as data on ICP numbers is published regularly by the Electricity Authority and Gas Industry Company, which enables meaningful comparisons using data prepared on the same basis. A breakdown of ICPs between residential, small and medium enterprises, commercial and industrial is available at a national level, but is not provided over time or at a GXP level.

¹⁰ Data sourced from <https://www.emi.ea.govt.nz/>

Activity	Mercury	Trustpower	To be acquired by Mercury
Retailing	Yes	Yes	Yes
Metering	No	No	No
Gas			
Production and first sale	No	No	No
Wholesale	No	No	No
Transmission	No	No	No
Distribution	No	No	No
Metering	No	No	No
Retailing NI reticulated gas	Yes	Yes	Yes
LPG bottle retailing	No	Yes	Yes
Other			
Fixed and wireless broadband	Yes	Yes	Yes
Mobile phone services	No	Yes	Yes

41. As evident from Table 1, the acquisition would bring together Mercury's and Trustpower's (former) activities in relation to mass-market customers for retailing:
- electricity
 - reticulated gas
 - LPG bottled gas
 - fixed and wireless broadband
 - mobile phone services.
42. As Mercury does not currently undertake bottled LPG and mobile phone services, the acquisition would not lead to any aggregation in retailing of these activities. We therefore do not discuss further the potential impacts on competition in the markets for bottled LPG and mobile phone services except in relation to customer bundling. The remainder of our report considers any potential competition effects of the acquisition in the electricity, reticulated gas, and broadband markets.

Relevant markets

Defining a market for competition analysis

43. The conventional first step for an economist in undertaking competition analysis is to define the relevant market or markets. A market is the field of exchange (or potential exchange) in which the goods and/or services being considered are substitutable. It is this possibility of substitution in response to changing prices or output that limits the ability of a firm 'to give less and charge more' (Re Queensland Co-operative Milling Association Ltd; Re Definance Holding Ltd, 1976).¹¹
44. Markets are multi-dimensional and are typically defined in terms of:
- product dimension—the goods or services exchanged between buyers and sellers
 - functional dimension—where the goods or services sits in the production or distribution chain
 - geographic dimension—the area within which the goods or services are obtained or supplied
 - temporal dimension—markets might have a temporal dimension or timeframe within which the market operates
 - customer dimension—markets may have a customer dimension, where different types of customers have different uses for or requirements of the goods or services.
45. We consider below each of these dimensions for electricity, reticulated gas, and broadband services.

Electricity, natural gas, LPG, and broadband are separate product markets

Energy markets

46. Electricity and gas are forms of energy. However, the Commerce Commission has previously found that electricity and natural gas are in different product markets, as they are not substitutable in response to a SSNIP (Commerce Commission, 2000, pp. 10-11). The phrase, SSNIP, refers to a 'small, yet significant, non-transitory increase in price'. A hypothetical monopolist profitably imposing a SSNIP is the test for the boundaries of a market (Commerce Commission, 2019(a), p. 18). The Commission argued that (Commerce Commission, 22 May 2009, p. 41):

in the main, consumers substitute between energy forms only when their energy consuming plant or appliance reaches the end of its economic life. Therefore, the Commission has considered the other energy forms to be at best 'imperfect substitutes'

¹¹ We consider further below whether bundling of services might impact on market definition or competition within the relevant markets.

[for electricity], and not to be regarded as being within the same product market as electricity. These findings are consistent with court judgments, and with the normal view of overseas competition authorities.

47. As an example of the 'normal view of overseas competition authorities', the Australian Competition Tribunal reached the same conclusion that there are separate product markets (Australian Competition Tribunal, 2014, p. 64).
48. The Commission has also concluded that reticulated natural gas is a separate product market from bottled LPG (Commerce Commission, 2018, para. 28).
49. We agree with the Commission's view that electricity and natural gas are separate product markets, and that reticulated natural gas is a separate product market from bottled LPG. The extent to which a SSNIP will result in a shift between electricity and natural gas, or between reticulated gas and bottled gas, will depend on the identity of the "marginal consumer" (or "marginal customer"), who is most likely to be influencing the prevailing market prices of those products. In this case, the "marginal consumer" is more likely to be a consumer who is adjusting the quantity of those products they consume, rather than one who is considering switching from one product to the other (for example, when choosing a replacement hot water system).

Broadband market

50. Broadband is not a substitute for energy and therefore is a separate product market from the markets for electricity and reticulated natural gas.
51. To date, the Commission has concluded that there is a single product market for broadband. It took this approach in the Vodafone/Sky case (Commerce Commission, 2017, pp. 75-76). When assessing the Infratil and Vodafone New Zealand transaction in 2019, the Commission considered whether broadband delivered by fixed-line was in a separate market to broadband delivered by fixed-wireless (Commerce Commission, 2019(b)). The Commission reasoned that technological advancements and changes in internet use could affect the degree of substitutability between different broadband technologies. The rise of content streaming and other data-hungry services might mean copper ADSL and VDSL broadband connections may no longer be good alternatives to fibre broadband for many customers. It noted that the fixed-wireless services available at the time were slower than fibre, so might not be good alternatives for all customers. It considered that this might mean that, in some cases, fixed-wireless and fibre would be in different markets. However, the Commission found it unnecessary to depart from a single broadband product market and commented that its competition analysis would not have been materially different if it had adopted separate markets.
52. We consider that the broadband market cannot be easily delineated by the technology used to deliver the service to end users. The drivers of substitutability that might be used to define separate markets would involve a complex interplay between the technology platform and its capabilities, its cost, the degree and timing of use, the number of connections and what content customers are accessing and the characteristics of that content. In this proposed transaction, the aggregation of broadband services would occur at the competitive retail level, with most wholesale markets regulated under the Telecommunications Act 2001.

53. In this retail market, Trustpower and Mercury offer broadband services delivered over fixed-line technology. Trustpower also offers fixed-wireless broadband. A single product definition of retail broadband would best encompass the actual and potential transactions between sellers and buyers and the factors that shape and constrain rivalry in providing these services. Furthermore, the characteristics of this transaction (discussed later in this report) mean that defining separate markets for fixed-line and fixed-wireless broadband would not alter our competition analysis.

Relevant product markets

54. For the reasons discussed above, we consider the relevant product markets for assessing the competitive effects of Mercury's acquisition of Trustpower's retail market assets are the product markets for:
- a) electricity
 - b) reticulated natural gas
 - c) broadband.

Functional and geographic markets

Functional markets

55. Each of the product markets involves a series of steps, or functional levels, to produce and supply the product to consumers. Whether these steps form separate functional markets for the purposes of competition analysis would depend upon whether a market defined at a single functional level captures all relevant substitution constraints (Smith & Walker, 1997, p. 13). Generally, the Commission identifies separate functional markets at each functional level, but more than one level of the supply chain may be in the same market if firms could easily move from one level to another (Commerce Commission, 2019(a), pp. 21-22).
56. As the acquisition concerns mass-market customers (residential and small commercial customers), we focus on defining the relevant retail markets for mass-market customers.¹² In our competition analysis, we consider whether changes in the retail activity of Mercury or Trustpower might impact on their activity in the wholesale electricity and gas markets.

Geographic markets

57. As with the other dimensions, the geographic scope of a market captures the factors that shape and constrain rivalry between sellers. The extent to which the location of both suppliers and customers is relevant in determining the geographic dimension of a market depends on the nature of the market (Commerce Commission, 2019(a), p. 20). If customers have to travel to a supplier's location to purchase a product, a market might be defined based on a supplier's

¹² We also consider the small number of commercial and industrial customers.

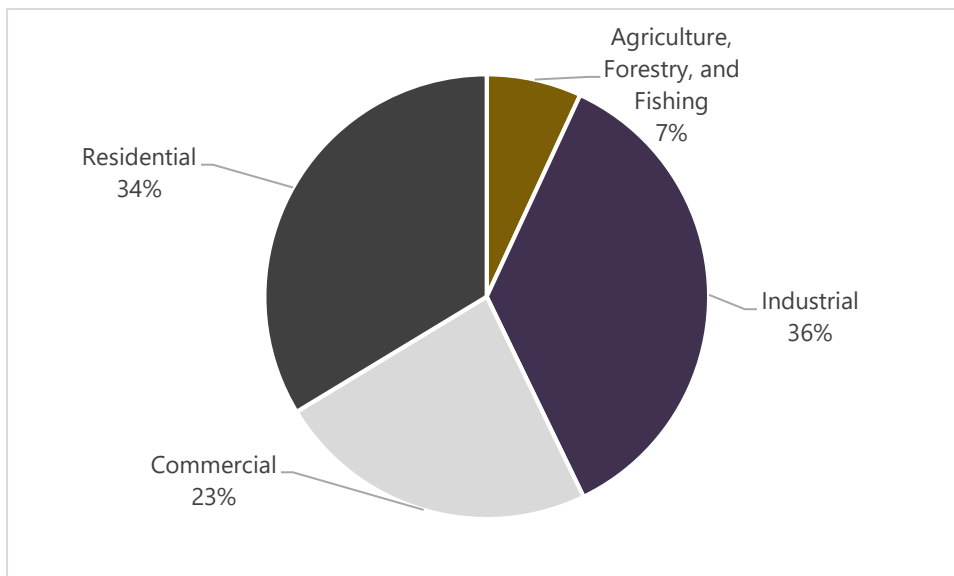
location. Alternatively, if suppliers can feasibly price discriminate because of a customer's location, a market might best be defined on the basis of the location of the customer.

58. Under both scenarios, the analytical approach is the same; that is, assessing whether supply from different locations are sufficiently close substitutes to be in the same market. In general, the smallest set of locations in which the SSNIP can be profitably sustained is the relevant geographic market (Commerce Commission, 2019(a), p. 18).

A national market for retail electricity

59. Total electricity generation in New Zealand was 42,639 GWh in the year to March 2021. Of this electricity, 39,035 GWh was available for consumption after losses in transmission and distribution. Divided into shares of consumption by type of activity, 33 per cent of consumption was residential, equating to 13,008 GWh. Figure 1 below illustrates the shares consumed by each sector as defined by the Ministry for Business Innovation and Employment (MBIE, 2021).

Figure 1 Percentage of total electricity consumption by sector – year to March 2021



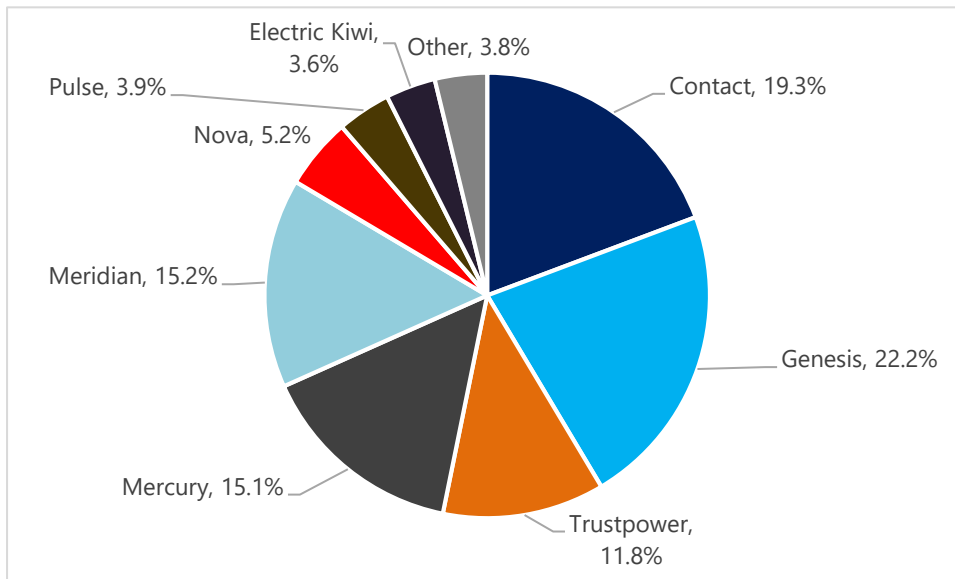
Source: MBIE/Sapere workings

60. Over a decade has passed since the Commission defined the geographic (and customer dimensions) of the retail market as either (Commerce Commission, 22 May 2009, para. 195):
- Separate markets for the regional sale of electricity to domestic retail customers (including small commercial customers) and the national sale of electricity to large commercial and industrial customers that have individual contracts with electricity retailers, or
 - A national market for retail customers, while noting that it may be appropriate to adopt narrower regional markets in some circumstances.
61. Subsequent evolution of the market means there is now a national market for retailing electricity to mass-market customers. Ten retailers currently supply customers in every distribution region. These retailers include the five largest retailers: Contact, Genesis, Mercury,

Meridian, and Trustpower. Smaller retailers Ecotricity, Electric Kiwi, Nova, Pulse and Vocus also retail in all regions. Flick Electricity has customers in all regions with the exception of The Lines Company, which has a unique distribution pricing regime.

62. The market shares of each of the retailers in the residential market are illustrated in Figure 2. Genesis is the largest retailer (operating under the Genesis and Energy Online brands) with 22.2 per cent of the market. Excluding the largest five, the sum of the market share served by the smallest retailers is 16.5 per cent.

Figure 2 Residential and SME retailer market shares by ICP number as at 30 June 2021

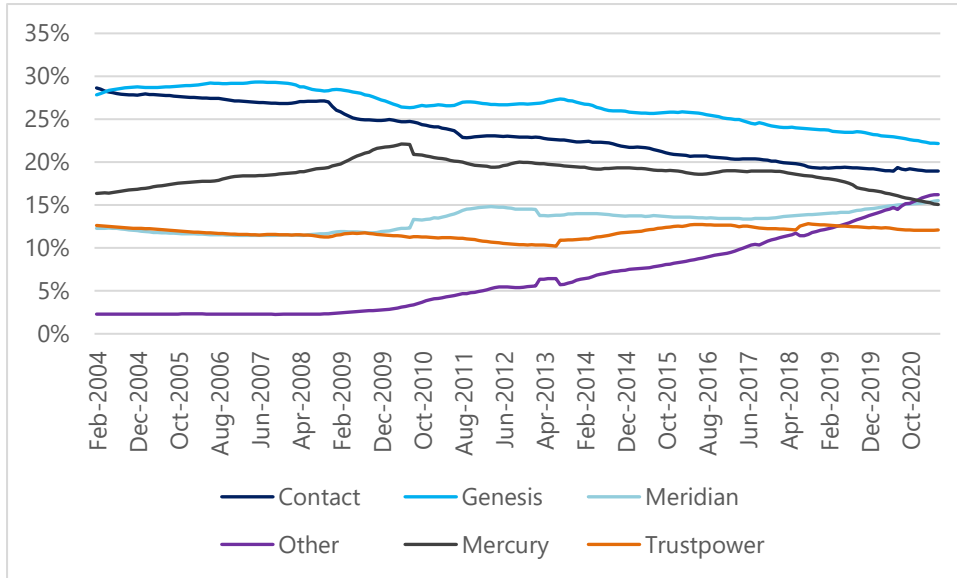


Source: Electricity Authority data/ Sapere workings

63. Since 2004, the combined market share of the five largest retailers has fallen relative to the other participants. Figure 3 illustrates how the aggregated share of small and medium retailers has risen from 2.3 per cent at the start of 2004 to 16.2¹³ per cent in May 2021. Over the past five years, the number of ICPs served by small and medium retailers has risen from 180,496 to 357,997, or an increase of 14.3 per cent compound annual growth rate (CAGR) measured by ICP number. Note that these figures are for all sectors, not just residential.

¹³ Note that this value differs from the reference in paragraph 62. This is because information broken down by market segment (e.g. residential) is not available going back in time.

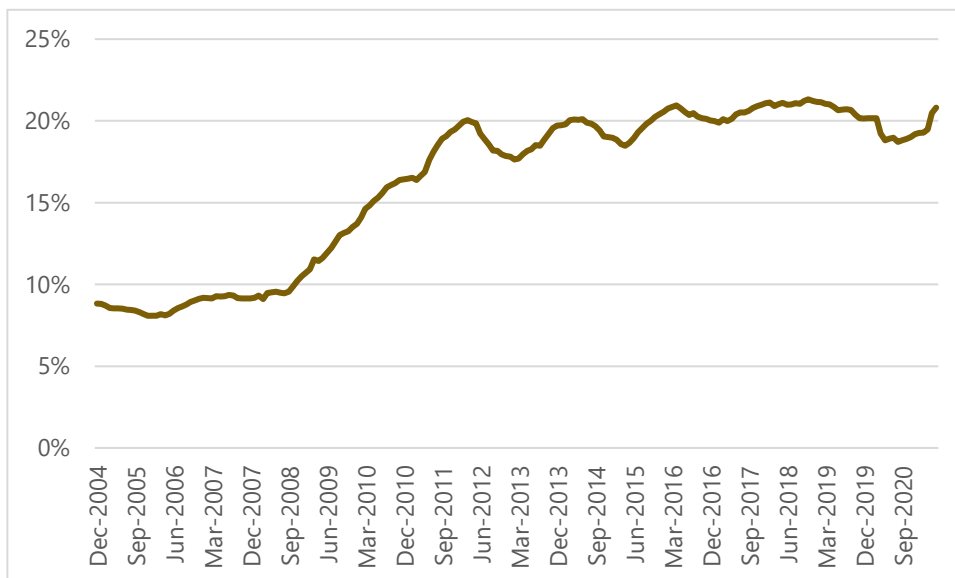
Figure 3 Market shares by retailer, 2004 to 2021



Source: Electricity Authority

64. The level of switching activity is illustrated in Figure 4. The level of switching has steadily risen from below 10 per cent until 2009 (when the Commission last considered whether there was a national retail market) and has remained above 20 per cent since October 2015 except for a COVID-19 related slump which has now been reversed. The rise in switching activity seems to coincide with the emergence of a number of small and medium retailers as shown in Figure 3; new, small retailers, were only beginning to enter the market in 2009.

Figure 4 Switching activity, rolling 12 month as a percentage of all ICPs, 2004 to 2021



Source: Electricity Authority

65. The comparatively large number of retailers operating over every distribution network area, and the high levels of switching, means that if a hypothetical monopolist were to impose a SSNIP in

a region, retailers operating in other regions could quickly expand without incurring significant costs making the SSNIP unprofitable. In our view, there is now a national market for retailing electricity to mass-market customers.

A North Island retail market for reticulated gas

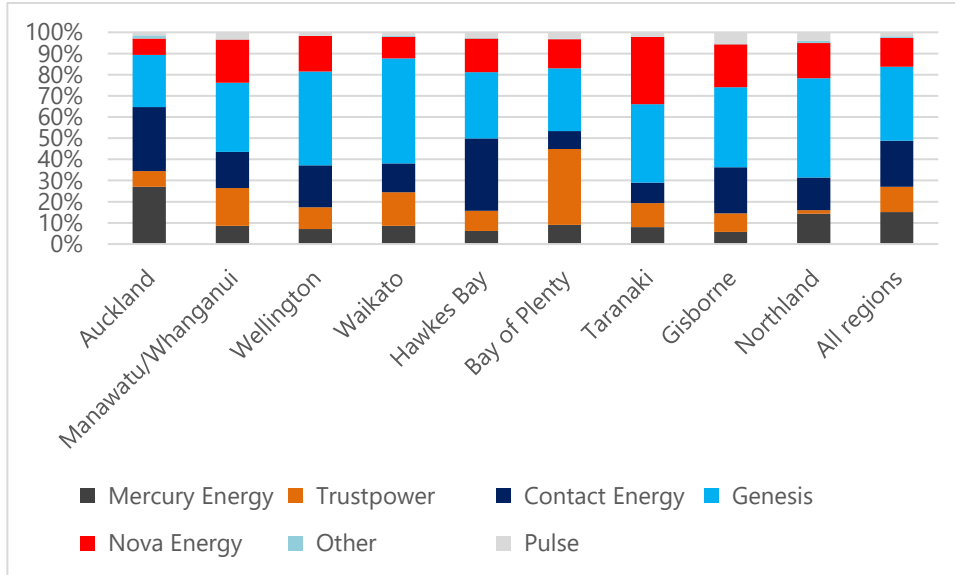
66. The existing high-pressure transmission pipelines are located in the North Island and hence the market for retailing reticulated gas is limited to the North Island. Retail consumption of gas represents a relatively small share of total gas consumption in New Zealand. In 2020, the data from MBIE showed that residential use of gas was 4.1 per cent of all gas consumed in New Zealand, while commercial use comprised 4.4 per cent. These percentages have not changed much in recent years.
67. When the Commission last considered the geographic boundaries of the retail gas market, it concluded there were localised geographic markets for mass-market gas customers corresponding to the geographic boundaries of the relevant distribution networks. It defined a separate North Island gas retail market for larger industrial and commercial consumers (Commerce Commission, 10 December 2004), (Commerce Commission, 17 March 2000). Competition in the gas retail market has evolved significantly since then:
- a) The Gas (Switching Arrangement) Rules 2008 established a gas registry and rules to facilitate switching. Between March 2009, the start of the registry, and December 2017, more than 63 per cent of residential and 66 per cent of small commercial sites switched gas retailer at least once (Gas Industry Company, 2017).
 - b) Tools such as powerswitch.org.nz have become available to assist gas customers with switching decisions. In the past year, an average of 4,149 customers have switched each month. Time to complete a switch has also reduced significantly from 'weeks or even months prior to the commencement of the Gas Registry in 2009' (Gas Industry Company, 2017) to an average of 2.04 business days in the year ended June 2021.¹⁴
68. Reflecting the comparative ease of entry for gas retailers, there are now six gas retailers present in each of the gas subsystems (Auckland/Northland, Waikato, Bay of Plenty, Taranaki, and lower North Island). The smallest retailer, Pulse, has 1.9 per cent of the North Island market by ICP count. The largest retailer, Genesis, which retails under both the Genesis and Energy Online brands, has 34.9 per cent of the market by ICP.¹⁵
69. Figure 5 shows the share of ICPs served by each gas retailer across each gas network. This chart illustrates that there do not appear to be significant barriers to retailing to mass-market gas customers, as the six largest gas retailers supply customers in each network. Even Pulse, the smallest retailer, maintains an island-wide presence. The industry regulator, the Gas Industry

¹⁴ <https://www.gasindustry.co.nz/work-programmes/switching-and-registry/current-arrangements/reports/>

¹⁵ We have chosen to divide the market up by geographic region rather than by distribution area, which we consider is a more useful breakdown. The distribution regions vary in size between Powerco, which has almost 110,000 ICPs, to Nova, which has only 216 ICPs. Our information does not allow us to distinguish between retailers in those distribution areas.

Company (GIC), notes that 99 per cent of gas customers may choose between seven retailers (Gas Industry Company, 2017).

Figure 5 Retailer ICP share by region – June 2021



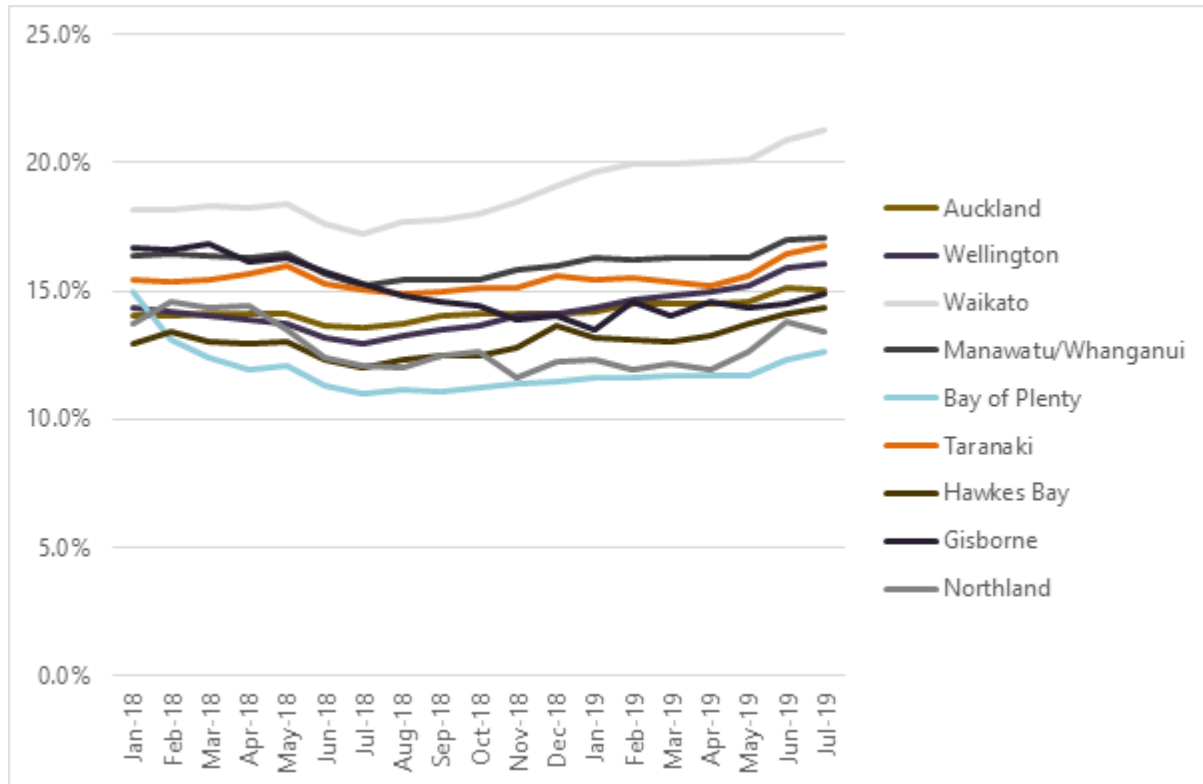
Source: Gas Industry Company data/ Sapere workings

70. A data series published by the GIC, beginning in January 2011, shows the average monthly number of switches on a rolling 12-month basis exceeded 4,000 in 2016 for the first time. There was a sharp decrease in switching in mid-2020 due to COVID-19 restrictions, but levels of switching have since recovered, with an average monthly number for the year ended June 2021 of 4,124.¹⁶
71. Figure 6 shows switching levels on a regional basis.¹⁷ The rate of switching is highest in the Waikato, with over 20 per cent of connections changing hands on an annual basis. Bay of Plenty has the lowest rate of switching but it has risen consistently since mid-2018. Most regions are centred around 15 per cent.

¹⁶ <https://www.gasindustry.co.nz/work-programmes/switching-and-registry/current-arrangements/reports/>

¹⁷ Note that these numbers have been derived on a different basis to the overall switching levels observed, which are calculated as a percentage of the retail, contestable connections, whereas the numbers presented here are as a percentage of all gas connections.

Figure 6 Annual switching rates between January 2018 – May 2021



Source: Gas Industry Company

72. The presence of six retailers operating over every gas distribution network, and the level of switching between retailers, means that if a hypothetical monopolist were to impose a SSNIP for customers connected to a gas distribution network, retailers operating in other regions could quickly expand without incurring significant costs making the SSNIP unprofitable. In our view, there is now a North Island market for retailing reticulated gas to mass-market customers.

A national market for wholesale electricity

73. The Commission has previously considered the wholesale electricity market to comprise three different markets—physical electricity, derivative contracts, and ancillary services (Commerce Commission, 22 May 2009). We disagree that these markets are separable for the purposes of competition analysis. In our view, hedge contracts are an element of pricing in wholesale market trading and ancillary services are an element of the quality of electricity, and both are inherent features of the wholesale market.
74. However, the parties will continue to act separately in the wholesale electricity market(s) following the transaction. As the parties will continue to act separately, any effect of the acquisition on competition in the wholesale electricity market(s) will only occur to the extent the incentives acting on the parties alter materially as a result of changes in their (vertically integrated) retail interests. Assessing whether their incentives would change materially does not turn on resolving whether there is one market for wholesale electricity, including derivatives,

supplied at a given level of reliability or three separate markets for physically supplied electricity, financial derivatives and ancillary services.

75. We therefore assess (in our competition assessment further below) whether the acquisition would have any competitive effects on the supply of electricity in the national wholesale electricity market, including the supply of derivatives and ancillary services if these are separate markets.

North Island market for wholesale gas

76. Neither Mercury nor Trustpower has interests that amount to ownership or control over production and supply of natural gas. Both are purchasers of gas in the wholesale market for supply to their residential consumers.
77. From the mass-market retail market shares of Mercury and Trustpower, we estimate that post-acquisition, Mercury will make 2.3 per cent of all gas purchases on the wholesale gas market. The volumes of gas that would be purchased by a single entity (rather than two separate entities) is too small a proportion of the wholesale gas market to give rise to any competition concerns. Therefore, we do not consider the wholesale gas market further.

National market for broadband

78. Under the Telecommunications Act 2001, the Commerce Commission regulates fixed-line and mobile services by setting the price and/or access terms for those services to promote competition for the long-term benefit of end-users of telecommunications services within New Zealand. These services are regulated because the Commission has determined that the markets for a variety of wholesale telecommunications services are subject to limited or no competition.
79. In recent years when assessing mergers, the Commission has also looked at retail telecommunications a number of times, including in Vodafone/Sky (Commerce Commission, 2017) and in Infratil and Vodafone New Zealand (Commerce Commission, 2019(b)). The Commission adopted a residential-only market in its analysis of retail broadband services in the Infratil and Vodafone New Zealand case.
80. The Commission also assessed if there were regional differences in the strength and offerings of different Telecommunications Service Providers (TSPs) that would support these markets being defined regionally. It cited Trustpower having a higher share of broadband connections in the Bay of Plenty area than in other parts of the country. However, the Commission stated that its inquiries indicated that the larger TSPs such as Spark, Vodafone, Vocus and 2degrees tended to operate on a national basis despite any regional differences in strength. It therefore adopted national retail markets for the purpose of that analysis but still considered regional differences in competition within its approach.
81. We agree that there is a national market for retail broadband services—Spark, Vodafone, Vocus and 2degrees continue to operate on a national basis.

Temporal and customer dimensions

Customer dimension

82. As noted at paragraph 56 above, the acquisition concerns mass-market customers (residential and small commercial customers).¹⁸ Our analysis therefore focuses on the competition implications for mass-market customers in the relevant markets.

Temporal dimension

83. In our view there is (generally) no temporal dimension to electricity, gas and broadband retail markets. The markets operate continuously over time. A hypothetical sole supplier in one period would not be able to impose a SSNIP without inducing other suppliers to shift supply into that period.

84. However, supply in the retail electricity, gas and broadband markets are potentially subject to being temporally limited in a region through network constraints. For any such constraints to be analytically relevant (to determining whether the proposed acquisition is likely to substantially lessen competition), they would need to be sufficiently predictable and of such magnitude and duration that a hypothetical sole supplier could profitably increase prices by a SSNIP. We consider whether there are temporally limited markets as a matter of fact further below in our competition analysis.

Conclusion on markets

85. For the reasons set out above, we consider the following markets are relevant for the analysis of the competitive effects of the proposed acquisition:

- the national market for retailing electricity to mass-market customers
- the North Island market for retailing reticulated gas to mass-market customers
- the national market for retailing broadband to mass-market customers.

86. For completeness, we assess whether the acquisition would have any competitive effects in the national wholesale electricity market, including on the supply of derivatives and ancillary services if these are separate markets. We also consider whether any of the markets are limited temporally or geographically.

¹⁸ With the exception of a small number of commercial and industrial gas consumers.

Competition assessment

Counterfactual

87. To assess whether a substantial lessening of competition is likely requires a comparison of the likely state of competition if the acquisition proceeds (often referred to as the factual) with the likely state of competition if it does not (often referred to as the counterfactual) (Commerce Commission v Woolworths Limited, 2008, para. 63). To undertake this comparison, a counterfactual needs to be described.
88. Several scenarios are possible if the acquisition did not proceed. Trustpower could:
- a) retain its mass-market retail business, including its current practice of offering its customers bundles of electricity, gas and broadband services
 - b) sell its mass-market retail business to a new entrant
 - c) sell its mass-market retail business to another existing mass-market retail business.
89. Scenarios (a) and (b) would not result in any additional aggregation in the relevant markets for analysis. Scenario (c) would result in more, or less, aggregation in the relevant markets compared to Mercury purchasing the mass-market retail assets, depending upon the entity assumed to purchase Trustpower's mass-market retail business.
90. In the analysis that follows, we adopt scenario (a), Trustpower retains its mass-market retailing business, as the counterfactual for the following reasons:
- a) As scenario (a) involves no aggregation in the relevant retail mass-market, a conclusion that the factual (the acquisition) would not result in a substantial lessening of competition should also hold relative to the other scenarios.
 - b) It has the benefit of being the status quo and therefore observable.
91. The relevant timeframe over which the likelihood of a substantial lessening of competition should be assessed depends on the market. Generally, the Commission has indicated that it will use a two-year timeframe to assess entry conditions, although this may vary depending on the facts of the case (Commerce Commission, 2019(a), p. 29). The High Court said (Woolworths & Ors v Commerce Commission, 2008, para. 130):
- The question is what can we determine now about the likely future. It is not a case of considering the likely effects only over a two to three year timeframe if, on the evidence, it can be said that it is likely that in the fourth or fifth year or later competition will be substantially lessened (even if it would not be in the first three years).
92. We consider current market conditions are the best guide to what would happen without the transaction. In arriving at this view for the electricity sector, we considered information and projections from a variety of sources including Transpower (Transpower, 2018(a)), the He Pou a Rangi Climate Change Commission (CCC) final advice and datasets (He Pou a Rangi Climate Change Commission, 2021), and the Ministry of Transport (Ministry of Transport, 2018).

93. The key structural events that are anticipated in the energy sector are:
- closure of the 750MW Huntly-Rankine units owned by Genesis Energy¹⁹
 - electrification of the New Zealand economy causing an increase in electricity demand
 - an increase in the use of Distributed Energy Resources (DER), particularly roof-top solar in the medium term
 - short-run under-capacity in the natural gas market affecting the availability of gas for electricity generation
 - the potential for reduced expenditure in gas production and transmission, depending on Government policy
 - an announced closure date for the Tiwai Point aluminium smelter
 - a stated Government policy of 100 per cent renewable electricity by 2030
 - a Government project to investigate storage options for dry year security, that is, the pumped hydro scheme referred to as NZ Battery.
94. The CCC was tasked with providing advice to the Government on the first three carbon budget periods – 2025, 2030, and 2035. The advice suggests budget targets for each period, a demonstration pathway to achieve the targets, and the associated policy recommendations. The Government is not bound to accept the CCC advice and is yet to fully respond. However, the Government has stated that it broadly agrees with the CCC advice, except for the electricity target where it holds to its stated, and higher, goal of 100 per cent renewable electricity by 2030.
95. The CCC expects the Huntly-Rankine units to close by 2025. The retirement of the Rankine units will significantly affect the portfolio of Genesis Energy, and through their swaption arrangement, Meridian Energy. However, the security of supply role provided by the Rankine units is still required in the wholesale market, and those companies that currently provide security of supply service have commercial incentives to provide the replacement generation for the security of supply role. The Government is also investigating the NZ Battery project, which is another potential supplier of security of supply.
96. The electrification of the New Zealand economy is expected to predominantly relate to the industrial and transport sectors over the next 30 years. Industrial demand for electricity is outside the customer dimension of the relevant markets, although it may disproportionately affect regional transmission constraints. The electrification of transport will have a relatively modest effect on residential electricity consumption in the short term and is offset by increasing levels of domestic roof-top solar. Energy efficiency will also make a difference. The CCC is forecasting only a 5 per cent increase in total residential consumption by 2030.

¹⁹ Genesis normally only operates two 250 MW units at a time on a rotating basis, but a third unit is available to run on an extended lead time.

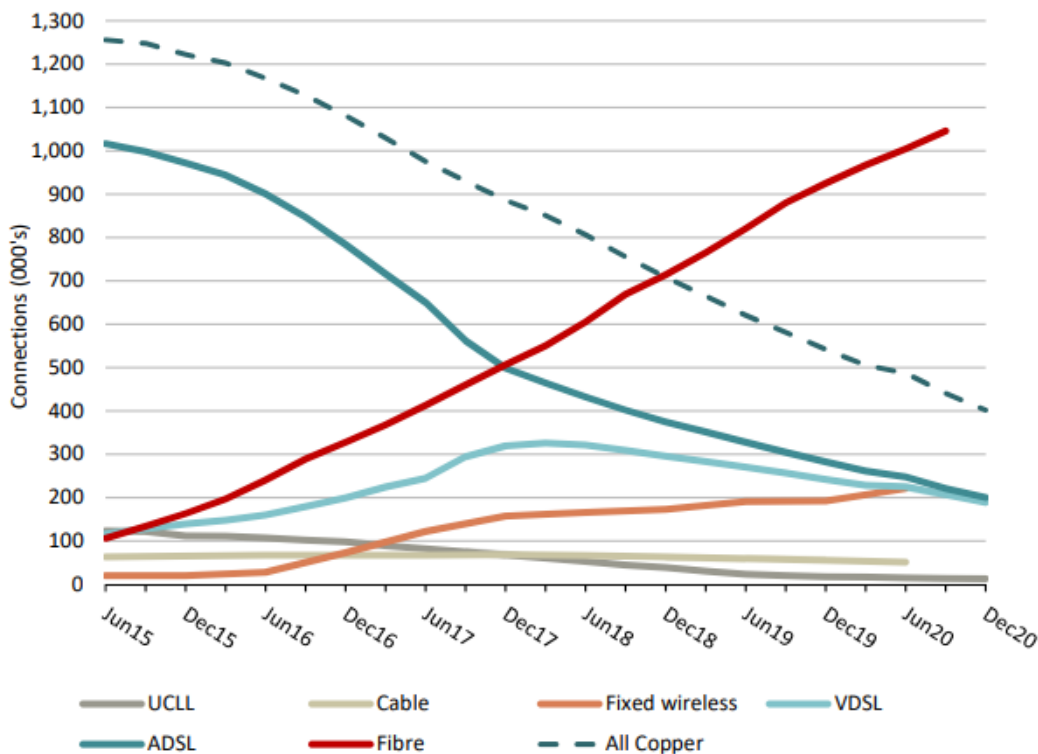
97. DER refers to technology such as solar PV, batteries, smart demand response (including smart charging of EV batteries), and Vehicle to Grid (V2G) use of EV batteries to help manage electricity supply. DER can compete with both lines and energy services and will increasingly provide consumers with a competitive alternative to purchasing bulk energy under the traditional energy retailing models. The change of technology at the consumer level will likely lead to new retailing models, competition, and innovation.
98. The NZAS aluminium smelter at Tiwai Point has announced that it will be exiting the New Zealand market. Its current stated exit date is the end of December 2024, although there is still some conjecture around this date.²⁰ When NZAS exits there will be a restructure of the industry at the wholesale level. This restructure will change some incentives for mass-market retail acquisition. Some generators, particularly Meridian and Contact, will be actively seeking customers, especially in the South Island. The exit of the smelter will put downward pressure on wholesale market electricity prices.
99. The hydroelectric generation released by NZAS will be somewhat offset by the potential exit of, or certainly reduced supply from, thermal generation in the North Island. The CCC is forecasting significantly reduced gas generation by 2030, which affects Genesis and may also affect Contact Energy and Nova. This anticipated reduction in generation from thermal units may cause some of these companies to reduce their retail customer numbers.
100. The Government's policy of ending new exploration permits for oil and gas will affect the gas industry. However, the relatively small portion of gas that is used for retail market supply, and the relatively large proven stock of gas reserves, suggest that sufficient gas reserves should continue to be available for the retail market over the relevant timeframe for analysis of this transaction. However, the CCC has suggested that the Government should consider halting expansion of the gas distribution network and also prohibiting new gas connections. An alternative option for Government is to encourage biogas in the network. There is therefore heightened uncertainty as to the future of the reticulated gas market.
101. The combination of this uncertainty in addition to the Government's restriction on new offshore oil and gas permits can be expected to cool investment, even in current infrastructure. With current capacity problems in the gas market, this reduction in investment may lead to the currently high electricity prices persevering for some time. These high prices will put pressure on retail competition in the near term.
102. The Government has adopted a policy of 100 per cent renewable electricity by 2030 and is also investigating the NZ Battery project to supply emissions-free dry-year reserve. The 100 per cent renewable electricity policy has been rejected by numerous analyses, including the CCC, on the basis that it will cause high electricity prices. Despite the 100 per cent renewable policy, the Government also accepts that the electrification of transport and industrial process heat offers far greater emissions reductions and needs competitive electricity prices for these conversions to occur. For the purposes of this analysis, we assume that over time the Government can be

²⁰ <https://www.nzas.co.nz/>

expected to follow through only on policies that keep electricity competitive with an economy-wide focus on emissions reductions.

103. With competitive wholesale electricity prices and greater electrification, innovation in DER and low barriers to entry, retail competition and retail innovation can be expected to continue to strengthen over time.
104. We are unaware of proposed changes in the telecommunications sector that are likely to be relevant to the competition analysis of this transaction. The characteristics of the telecommunications sector, as illustrated in Figure 7 below, include:
- households continuing to move away from landlines for calling; over half of household fixed line connections now have no voice service (naked broadband)
 - continued fall in copper broadband connections while fibre and fixed wireless broadband connections rise (from August 2021, Chorus will be able to stop supplying copper services in areas where fibre is available)
 - continued build of the ultra-fast broadband network, so that by the end of 2022, over 1.8 million households and businesses, or 87 per cent of New Zealanders, should have the ability to connect to fibre
 - continued increase in fixed wireless connections; as at 30 June 2020, New Zealand ranked third highest out of the OECD countries for fixed wireless broadband connections with 4.5 subscriptions per 100 of population, behind the Czech Republic at 14.9 and the Slovak Republic at 7.9).

Figure 7 Fixed-line broadband connections by technology



Source: Commerce Commission, Annual Telecommunications Monitoring Report 2020

105. Within this counterfactual for broadband those TSPs with a larger share of broadband connections than Trustpower and Mercury account for about 80 per cent of all broadband connections.
106. For these reasons, we adopt the status quo as the relevant counterfactual over the analytical horizon.

Competition effects in retail market for electricity

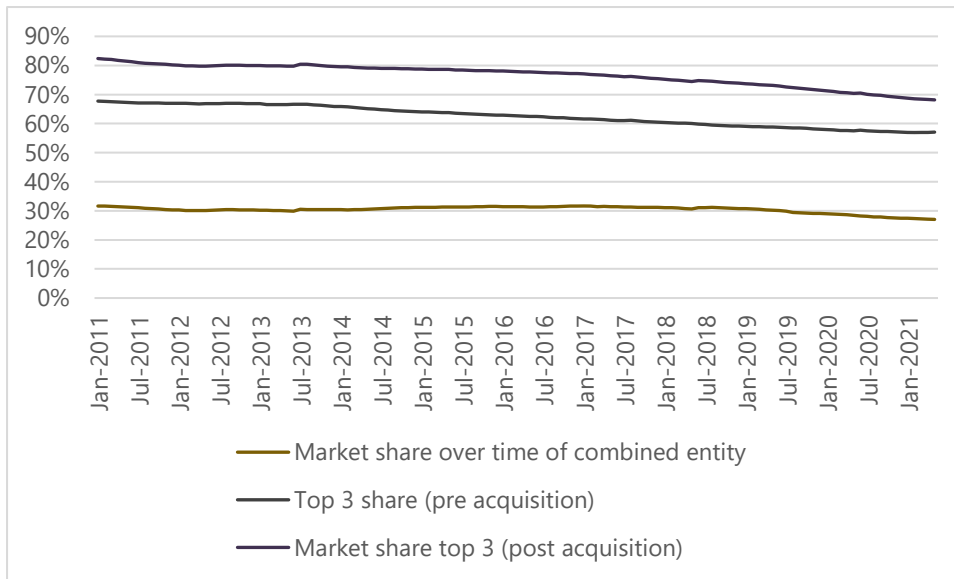
Existing and post-acquisition market shares

107. Prior to the transaction, the retail electricity market is characterised by five large retailers (some of which operate several brands) and around 32 other competing retailers of various sizes and longevities. Post-transaction, Mercury would have a retail market share of 27.0 per cent based on ICP numbers. Its two largest competitors would be Genesis with 22.1 per cent and Contact with 19.0 per cent market shares. Hence, post-transaction, the national market share of the three largest retailers, measured by number of ICPs, would be 68.4 per cent.
108. These post-transaction market shares would be within the Commission's market share and concentration indicators. The Commission indicates that a merger is unlikely to require a clearance application when post-merger the three largest firms in the market would have a combined market share of less than 70 per cent, and the merged firm's combined market share is less than 40 per cent (Commerce Commission, 2019(a), p. 23). However, as the Commission observes, a merger not exceeding the market share indicators might still substantially reduce competition if market shares understate the competitive importance of the merging firms (Commerce Commission, 2019(a), p. 23).

Market shares might overstate, rather than understate, competitive importance

109. Figure 8 below shows that the market shares of the top three has been trending downwards over the past 10 years. The trend would still have been down, if Mercury's and Trustpower's retail operations are aggregated.

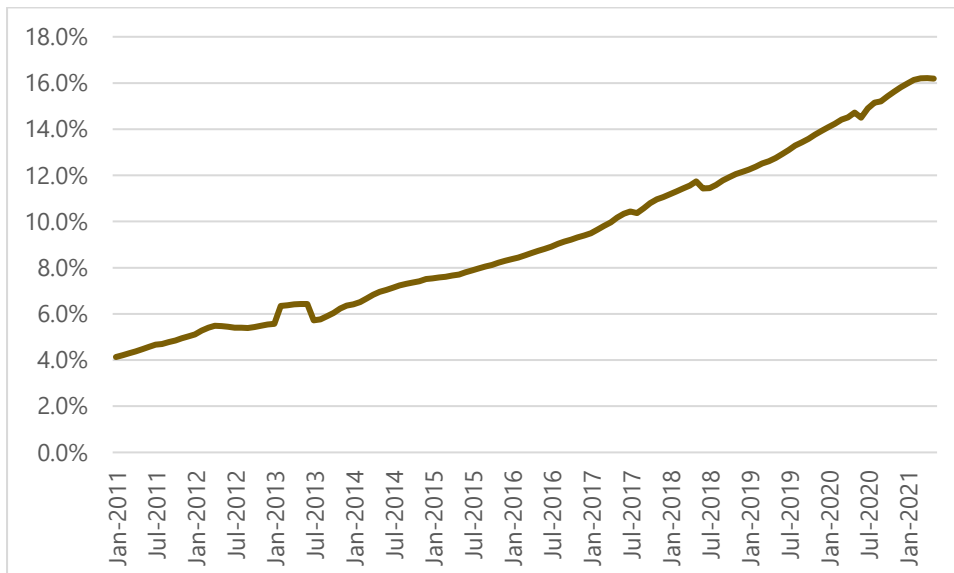
Figure 8 Market share (measured by ICP) – 2011-2021



Electricity Authority data/ Sapere analysis

110. The market shares of the largest retailers have fallen since 2011, as new retailers have entered the market and increased market share, although there are also material levels of switching between the larger retailers. Figure 9 illustrates how the summed share of small and medium-sized retailers has risen from 4.1 per cent in January 2011 to 16.2 per cent in May 2021. Over the past 10 years, the number of ICPs served by small and medium sized retailers has risen from 82,152 to 357,997, a compound annual growth rate (CAGR) of 14.6 percent per annum.²¹

Figure 9 Market share of small retailers – 2011-2021



²¹ Note that these figures are for all sectors, not just residential.

111. The ability of new retailers to enter the market and gain market share suggests entry barriers are relatively low. This view is consistent with the advice of the Electricity Price Review, which found (Electricity Price Review, 2018, p. 42):

Of today's 37 retailers, 28 are new since 2011. At first glance, this would suggest there are few or no barriers to entry. Undeniably, barriers have previously stood in the way of new entrants. But the Electricity Authority has done a lot to lower them by removing unduly strict prudential requirements on retailers, improving contract market liquidity, actively providing information to new entrants, and interpreting more flexibly the technical requirements of entry.

112. As discussed above (see Figure 4), annual switching rates have exceeded 20 per cent since mid-2015 and, but for a mid-2020 COVID-19 related dip, have remained above 20 per cent since.
113. In short, the competitive landscape of the New Zealand electricity retail market is characterised by multiple competitors, ease of entry, high levels of customer switching between competing retailers, and ongoing implementation of regulatory initiatives by the Electricity Authority to support small retailers and consumer switching. This competitive landscape means Mercury, post-acquisition, would not be able to profitably sustain a SSNIP. That is, the acquisition by Mercury of Trustpower's mass-market electricity retail business would not substantially lessen competition in the national market for retailing electricity to mass-market customers.

Competition increased if electricity markets are limited temporally

114. The analysis above considered competition in the national electricity retail market, which we consider the relevant market (see paragraphs 59 to 65). We have also considered the competition impacts if there are markets limited temporally or geographically.
115. Table 2 shows the GXP's where Trustpower and Mercury's combined share of the ICPs served from that GXP exceeds 45 per cent. We separate out these locations for further analysis to assess whether there are any transmission limits or other constraints that might reduce competition at these locations relative to the competitive pressure being experienced in the national retail market. We note that the Electricity Authority adopts varying regional boundaries when reporting on retail competition. It sometimes uses a breakdown by regional council (Electricity Authority, 2018). It also publishes data aggregated by distribution networks as they existed in 2003.²² We were not able to locate an explanation for why the Authority uses these regional decompositions, but they do not appear to result from considering whether retail services are substitutable (the test in competition economics for defining a market boundary). For example, the Authority's categorisation would have customers in New Lynn being in a separate geographical market from Avondale, as New Lynn is in the former Waitemata network and Avondale is in the former Auckland network, both former networks are now owned and

²² <https://www.emi.ea.govt.nz/Retail/Datasets/MarketStructure>

operated by Vector. We see no basis in competition economics for considering households in New Lynn to be in a different regional market from households in Avondale.

116. Most of the GXPs listed in Table 2 are locations where Trustpower's existing share of ICPs exceeds 40 per cent and Mercury's share of ICPs is less than 10 per cent; there are two Auckland GXPs where Mercury currently serves just over 40 per cent share of the ICPs supplied by the GXP. The 13 GXPs listed in Table 2 make up just under seven per cent of the 196 GXPs that retailers and major users buy electricity from the wholesale market (Electricity Authority, 2018, p. 42).

Table 2 GXPs where combined entity would serve 45 per cent or more of ICPs as at May 2021

Location	Distributor	Total ICPs	Trustpower market share	Mercury market share	Combined share
Dobson	West Coast (Westpower)	2891	42%	5%	47%
Greymouth	West Coast (Westpower)	4404	41%	7%	48%
Hokitika	West Coast (Westpower)	4576	39%	8%	47%
Hangatiki	King Country (The Lines Company)	11559	48%	5%	53%
Kaitemako	Tauranga (Powerco)	9029	58%	7%	65%
Kumara	West Coast (Westpower)	630	47%	9%	56%
Mangere	Auckland (Vector)	26225	6%	42%	47%
Mt. Maunganui	Tauranga (Powerco)	23427	58%	7%	65%
National Park	King Country (The Lines Company)	828	63%	2%	65%
Ohakune	King Country (The Lines Company)	2076	52%	3%	55%
Ongarue	King Country (The Lines Company)	4476	55%	3%	58%
Pakuranga	Auckland (Vector)	45721	7%	41%	48%

Location	Distributor	Total ICPS	Trustpower market share	Mercury market share	Combined share
Tauranga	Tauranga (Powerco)	10114	58%	7%	65%

117. The GXP's listed in Table 2 can be categorised into four regions:

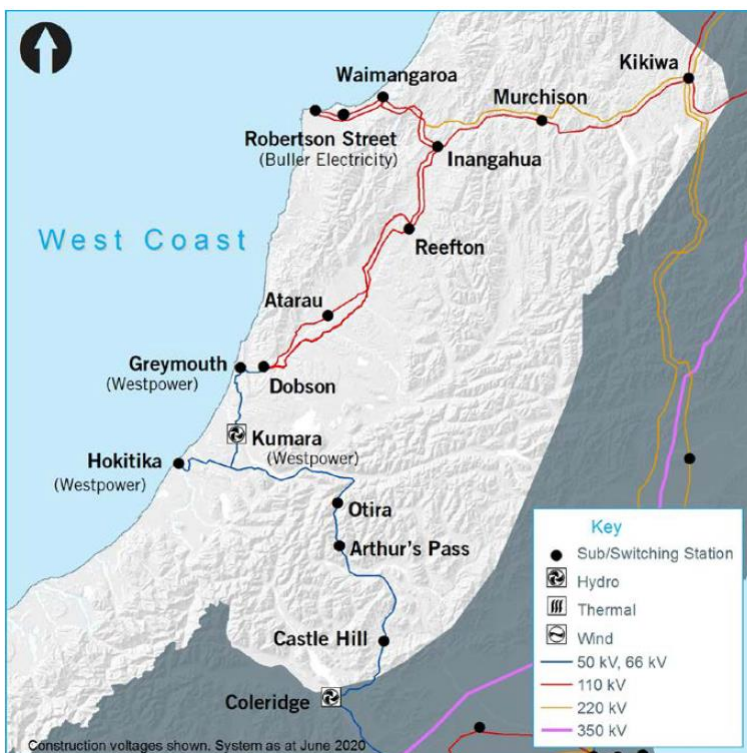
- West Coast of the South Island
- King Country
- Bay of Plenty
- Auckland.

118. We consider each region in turn.

West Coast of the South Island

119. The West Coast of the South Island has relatively weak transmission. It is one of the few areas of the grid where some of the region is supplied by 66 kV lines, where normally lines would be at least 110 kV and the core grid is built at 220 kV. The West Coast connection to the core grid is at 66 kV, via the Coleridge power station, and a stronger connection through 110 kV to Kikiwa. Kikiwa also feeds the Nelson-Marlborough area.

Figure 10 West Coast transmission schematic



Source: Transpower's Transmission Planning Report 2020

120. Collectively, Nelson-Marlborough and West Coast (the Upper South Island) import significantly more power than is generated locally. When electric power must travel long distances, on relatively weak transmission, then managing voltage into the region can be a significant problem.
121. The Upper South Island has a history of voltage problems. Transpower outlines existing and potential transmission problems, with potential solutions, in its Transmission Planning Report, (2020). Based on prudent design forecasts, the Transmission Planning Report anticipates voltage problems and constraints into Hokitika potentially as early as 2021. In the worst case, no more power could be imported into the region without local generation stabilising voltage. These input restrictions can lead to elevated prices in the Upper South Island, with local generation with discretionary capacity potentially having transitory market power.²³
122. Trustpower has significant generation with some discretion in the region with McKays Creek, Kaniere Fork, Wahapo, Hokitika Diesel, Dillman's and Kumara giving 17 MW of discretionary capacity. Trustpower also has another 3 MW of 'run of river' capacity at Arnold. However, there is local competition, especially from Amethyst Hydro, which adds 7 MW of discretionary capacity and was specifically designed to help stabilise local voltage.
123. Local generation capacity also competes with transmission upgrades. There has been significant investment into both transmission capacity and voltage management equipment in recent years, and Transpower is considering adding more voltage management equipment, and/or transmission line upgrades.
124. The transaction will therefore ameliorate the current situation where a retailer wishing to compete with Trustpower's retail offer on the West Coast may need to contract with Trustpower (as a generator) if the retailer wishes to cover locational price risk. Mercury will not have a direct supply advantage in the West Coast. [], Kikiwa is an FTR node, which means that any other retailer can access liquid exchange traded instruments to hedge at Kikiwa, []. Post transaction, all retailers will take the same risk from Kikiwa to the West Coast nodes.
125. Hence, the transaction is likely to be pro-competitive for retail customers on the West Coast, notwithstanding the small increase in the number of ICPs served by Mercury at the West Coast GXPs.

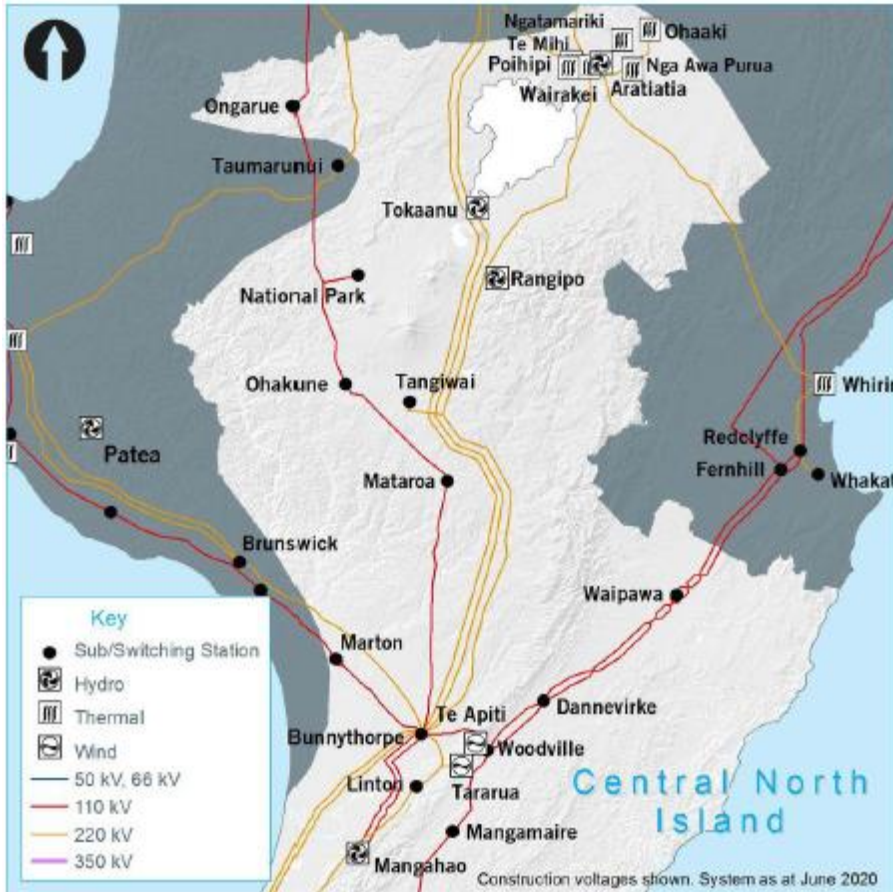
King Country

126. Trustpower became the majority shareholder of King Country Energy in 2015 and formally took over its retail customers in 2018. The traditional retailing nodes for King Country Energy are Ongarue, National Park, and Ohakune. All three are on an old 110 kV line in parallel with the

²³ Discretionary capacity means the operator of the plant can choose the timing of any generation: a hydro generator with storage had some discretion on when to use the stored water for generation; a run-of river hydro generator has little discretion and generates in accordance with the waterflow.

220 kV core grid from Bunnythorpe to Arapuni shown in Figure 11. While this 110 kV line is relatively weak, the demand on it is not high and there is little generation that can affect it.

Figure 11 Central North Island transmission schematic



Source: Transpower's Transmission Planning Report 2020

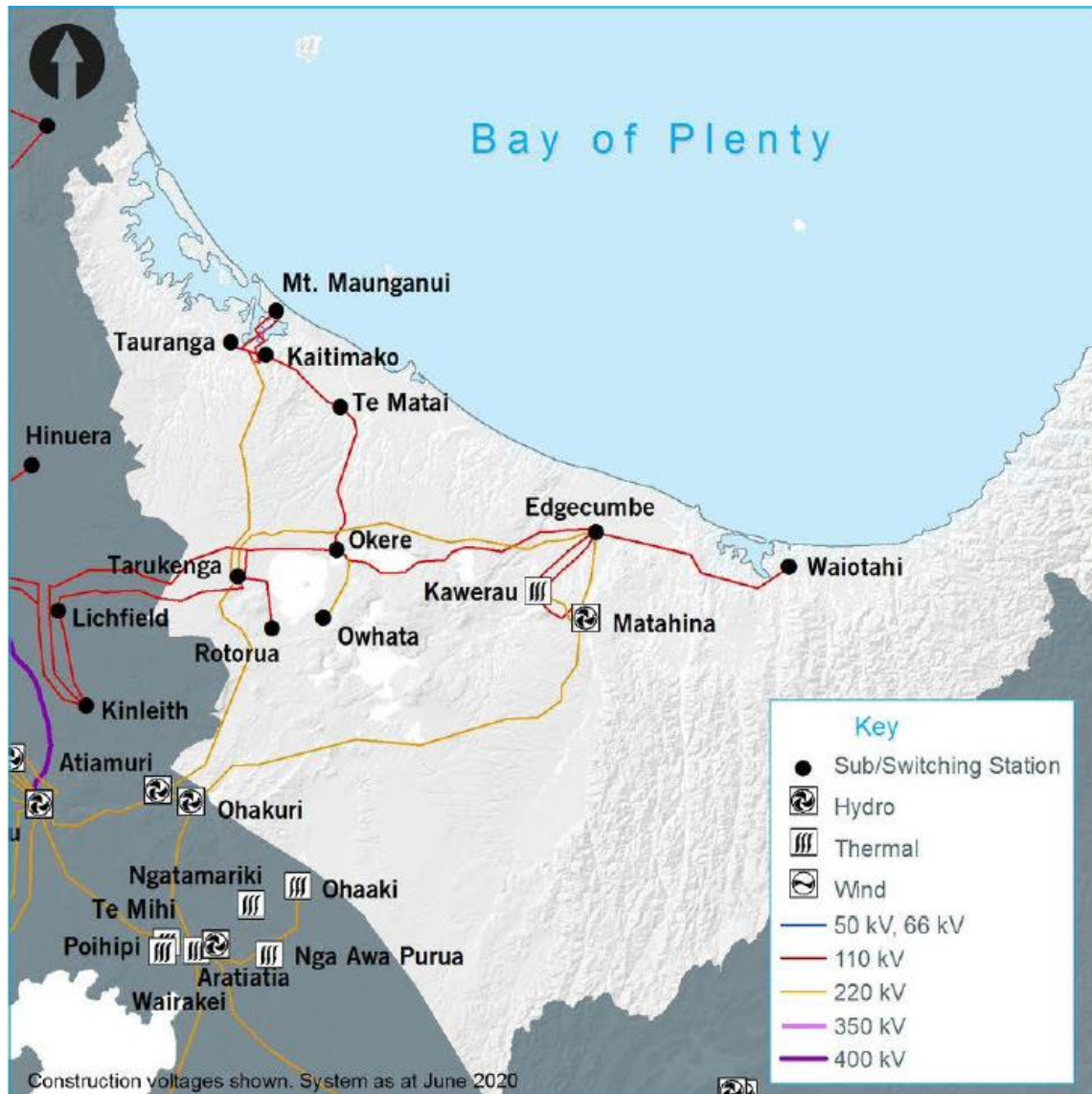
127. King Country Energy had significant market share for a long period. This is probably due to the area's remoteness and low population density, making the area a low priority for marketing campaigns for competing retailers. However, since the inception of Electricity Authority's focus on retail competition in 2009, King Country Energy's market share steadily declined.
128. This trend continued when Trustpower took over King Country Energy's retail business and King Country Energy exited the retail market—see Figure 12 in Appendix A. If anything, Trustpower's rate of decline in market share may have increased from that experienced by King Country, possibly because King Country Energy was a local business and may have had local loyalty.
129. Mercury currently ranks a distant fifth in the region. There are no transmission issues that might set back the demonstrated entry of retailers into the region or separate the area from the competitive national retail electricity market.

Bay of Plenty

130. Bay of Plenty has reasonably strong transmission but is not on what is known as the core grid. It is a regional network connected to the 220 kV core grid at Ohakuri and Ātiamuri. There is also a

weak 110 kV connection to Arapuni but this is normally left open. Within the region there are spur lines to some major load centres. Rotorua is on such a spur. The Tauranga and Mount Maunganui region are supplied by two lines but are little more than a spur line. The transmission circuits supplying the Bay of Plenty are illustrated in Figure 13.

Figure 13 BOP transmission schematic



Source: Transpower's Transmission Planning Report 2020

131. Trustpower has generation at Tauranga, Mount Maunganui, Rotorua, and a significant generator in the Bay of Plenty region at Matahina. Prior to the transaction, Trustpower served 50 to 60 per cent of the ICPs in these cities and the region generally (see Table 2 above).
132. Demand is predicted to grow in the Bay of Plenty region, so potential transmission constraints are predicted. Transmission capacity to Tauranga and Mount Maunganui is predicted to get tight and will increasingly need Trustpower's Kaimai power scheme to maintain a secure supply. However, Transpower has short-term plans for increasing supply capacity in the region and is in discussion with Powerco on long-term solutions (Transpower, 2020). The Bay of Plenty is a

densely populated region and so regional upgrades, and core grid upgrades, will almost certainly be economic when required.

133. []. This is an FTR node and so competitors can access liquid exchange traded contracts at this node, although not necessarily at the same price or profile. Both Whakamaru and Kawerau have significant generation supply and so it is also likely that creditworthy competitors could access Over-The-Counter (OTC) contracts at both nodes.
134. There are, therefore, no physical constraints of any significance that would impede a competing retailer from entering or expanding its market share, or cause competition in the Bay of Plenty to be less than elsewhere in the national electricity retail market. The acquisition of Trustpower's mass-market electricity retail business is therefore unlikely to substantially lessen competition in the Bay Plenty.

TECT distribution

135. Trustpower's customers in Tauranga and the Western Bay of Plenty region have to date received a rebate from the Tauranga Energy Consumer Trust (TECT).²⁴ To be eligible for the rebate, a customer had to be with Trustpower for a period of time specified by the TECT (typically, 6 months to a year). The median rebate payment over the past five years was \$500 (TECT, 21 May 2021). About 49,000 Trustpower customers—that is, about all of its Tauranga customers—received the rebate (TECT, 21 May 2021).
136. We understand that the TECT is proceeding with a restructure that will mean Trustpower customers, as at 28 January 2021, will continue to receive the rebate if they remain with Trustpower or with the entity that acquires Trustpower's retail business (in this case, Mercury) (TECT, 21 May 2021). The rebate will not be available to Mercury's existing customers, nor to any new customers, whether the customer is acquired by Trustpower or by Mercury. As the entitlement to the rebate is not changed by the transaction, any competitive effects of the rebate are not altered by the transaction.

Auckland

137. Mercury currently serves about 41 – 42 per cent of the ICPs supplied by the Mangere and Pakuranga GXPs. Trustpower serves about 6 to 7 per cent, so post the transaction Mercury will serve about 48 per cent of the ICPs supplied through these GXPs.
138. There are no transmission issues that might separate Mangere and Pakuranga GXPs from the competitive national retail electricity market. As discussed above, the transaction will not substantially lessen competition in the national electricity market; that conclusion holds particularly strongly in Auckland where retail customers have a choice of around 30 retailers.²⁵

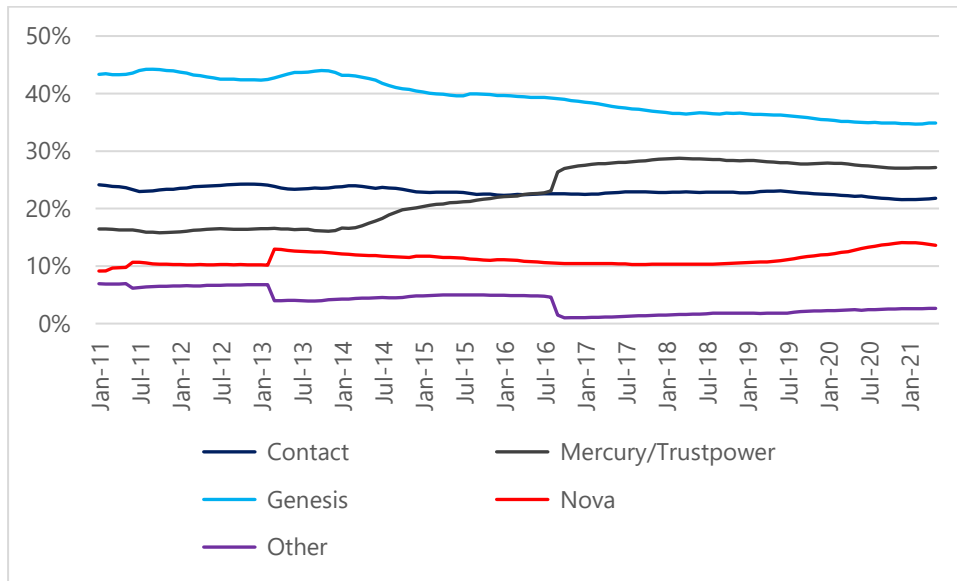
²⁴ <https://www.tect.org.nz/rebate-faqs/#2020>

²⁵ <https://emi.ea.govt.nz>

Competition effects in retail market for gas

139. The retail gas market is characterised by six gas retailers present in each of the gas subsystems or regions, with other smaller retailers present in some regions. Post transaction, Genesis would remain the largest retailer with 34.9 per cent of the market by ICP. Mercury would be second largest, with a market share by ICP of 27.1 per cent, followed by Contact with 21.8 per cent. Hence, post-transaction, the national market share of the three largest retailers, measured by number of ICPs, would be 83.8 per cent. Nova would have 13.6 per cent and Pulse with 1.9 per cent.
140. These post-transaction market shares would be outside the Commission's market share and concentration indicators (see discussion at paragraph 108). However, as the Commission observes, the mere fact that a merger exceeds one of these indicators would not mean it would be likely to substantially lessen competition (Commerce Commission, 2019(a), p. 23); market share measures are insufficient in themselves to establish whether a merger is likely to have the effect of substantially lessening competition.
141. As the Australian Competition Tribunal observed (Australian Competition Tribunal, 2014, p. 88):
- There is nothing inherently wrong with a market in which three large firms compete vigorously for market share where there are incentives to steal customers away from rivals. It is behaviour that matters, not structure per se. It appears to the Tribunal that it has been invited to assume that the "Big 3" will not constitute a competitive market principally on the basis of their combined market share immediately post-acquisition on an assumption that competition between them would become muted over time. In the opinion of the Tribunal, oligopolies should not be thus prejudged.
142. Figure 14 below shows that the market shares of the largest four retailers in the gas market, aggregating Mercury and Trustpower's retail operations. The market share of the largest retailers has been trending downwards. In October 2016, the three largest retailers (assuming Trustpower and Mercury as a combined entity) had a combined market share of 89 per cent. By May 2021, this measure had fallen to 84 per cent.

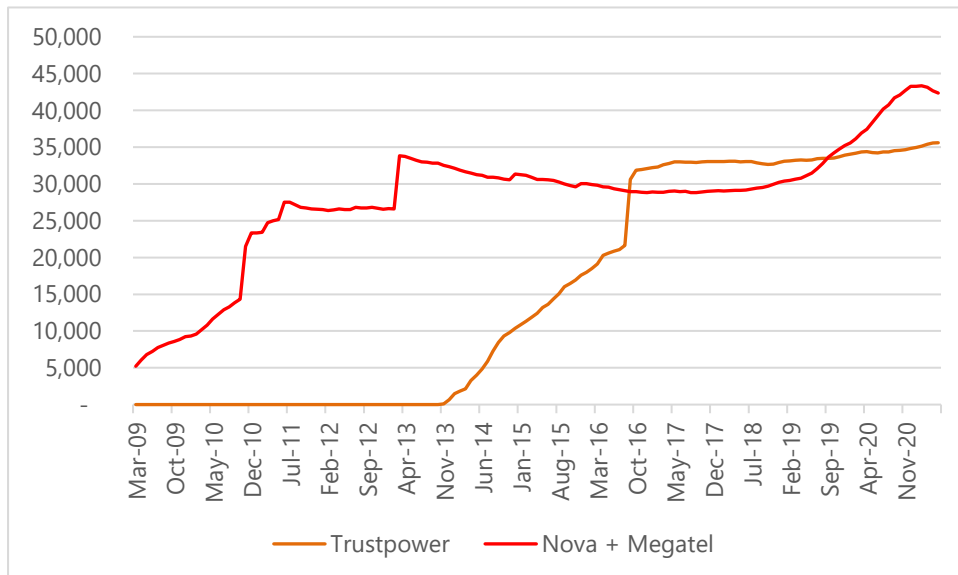
Figure 14 Market shares (January 2011 to present) with Mercury and Trustpower presented as a combined entity



Source: GIC data/ Sapere workings

143. The market share of the largest retailers has been falling because new retailers have been able to enter the market and grow market share. Figure 15 shows that two retailers (Nova and Trustpower), which between them now supply over a quarter of the market, had only two per cent of the market in 2009. Their growth, through a combination of acquisition of other retailers and organic growth, is indicative that there no material barriers to entry in the North Island market for reticulated gas.

Figure 15 Customer numbers – Nova (including Megatel) and Trustpower since 2009



144. The uncertainty resulting from government policy in relation to gas use, and the characterisation of gas use as being contrary to carbon reduction objectives (He Pou a Rangi Climate Change Commission, 2021), is likely to impact on the number of new entrants retailers that might be expected in North Island market for reticulated gas. Unlike in the electricity

sector, the market dynamics for the gas market may take on characteristics similar to a declining industry—that is, an expectation of higher levels of concentration to achieve efficiency of scale over a potentially reducing total customer base.

145. The North Island market for reticulated gas would be characterised post acquisition as having three large retailers—Genesis, Contact and Nova—competing with Mercury across all gas networks, sustained customer switching levels, and low barriers to entry as evidenced from entry and growth of new competitors in recent years. These characteristics mean that the acquisition by Mercury of Trustpower’s gas retail customers would not result in a substantial lessening of competition in this market.

No regional constraints to competition

146. There are five gas gates where the combined share of Mercury and Trustpower’s retail base would exceed 50 per cent as shown in Table 3.

Table 3 Gas gates where combined market share of Mercury and Trustpower exceeds 50 per cent

Name	Trustpc	Mercur	Combir
Mt Maunganui	47%	9%	56%
Papamoa	44%	10%	55%
Pyes Pa	42%	14%	56%
Te Puke	55%	6%	61%
Tauranga	50%	8%	58%

Source: GIC data/ Sapere workings

147. All of these gas gates are located in Tauranga and the Western Bay of Plenty. There are no physical characteristics of gas supply at these gates which would distinguish them competitively from gas gates elsewhere in the North Island market for reticulated gas.
148. Existing Trustpower customers have had access to the TECT rebate, which may have encouraged some customers to choose Trustpower in the region—along with other factors such as Trustpower being a ‘homegrown’ brand, having its head office in the region, and sponsoring community services such as the rescue helicopter. It is possible that Trustpower was able to leverage those local advantages in bundling gas with its electricity offer to dual fuel customers.
149. As discussed above, we understand that the TECT is proceeding with a restructure. This restructure will mean that the entitlement to the rebate is not changed by the transaction; hence, any competitive effects of the rebate are not altered by the transaction.

The wholesale electricity market (including electricity derivatives and ancillary services)

150. Both Mercury and Trustpower operate generation plant in the wholesale electricity market. Neither party increases nor decreases its generation capacity as a result of the transaction.

151. Prices discovered in wholesale electricity markets are among the most volatile of all markets. To manage the financial risk of volatile spot prices, generators (and retailers and major users) enter into “hedge” arrangements, either in the form of financial contracts or by integrating with retailers (generators); vertical integration between generation and retail is sometimes referred to as a physical hedge.
152. The transaction will result in Mercury increasing its physical hedge (retail base) by approximately 1.8 TWh, and Trustpower will decrease its physical hedge by the same quantum.²⁶ [].²⁷
153. In our view the proposed hedge arrangements are consistent with prudent risk management expected in workably competitive markets. []. The pricing nodes for the hedge contracts are FTR nodes and, therefore, competitors can purchase liquid exchange traded instruments at the same nodes.
154. We have assessed the transaction, and resulting hedge arrangement, against the issues raised in the 2019 Electricity Price Review. The Review concluded that vertical integration was likely to be publicly beneficial overall, but expressed concerns regarding the transparency of hedge prices and other information. Its recommendations are being advanced by the Electricity Authority.
155. The proposed transaction is likely to promote the objectives of the Electricity Price Review. Trustpower will become primarily a merchant generator, and therefore will likely increase the volume of financial hedges it offers into the market over time.²⁸ While Mercury will become a larger retailer, the transaction will not result in Mercury becoming a commensurately larger generator. [], we would expect Mercury to trade more OTC and exchange traded derivatives than it would under the counterfactual, subject to further investment in generation, which is an option open to all market participants. These additional trades of Over-The-Counter (OTC) and exchange traded derivatives would increase the liquidity and transparency of price discovery of hedge prices relative to the counterfactual.
156. Lastly, we note the Electricity Price Review did not express concerns with OTC hedge arrangements of the type proposed between Mercury and Trustpower in conjunction with the retail purchase. As a market participant and the seller, Trustpower will be required to disclose the hedge information to the Electricity Hedge Market Disclosure System under clause 13.218 (1) of the Electricity Industry Participation Code 2010. The hedge information will also be subject to Electricity Authority oversight.

²⁶ From Trustpower’s 2020 annual report, and assuming spot and TOU sales equate to the C&I customer load retained by Trustpower.

²⁷ [].

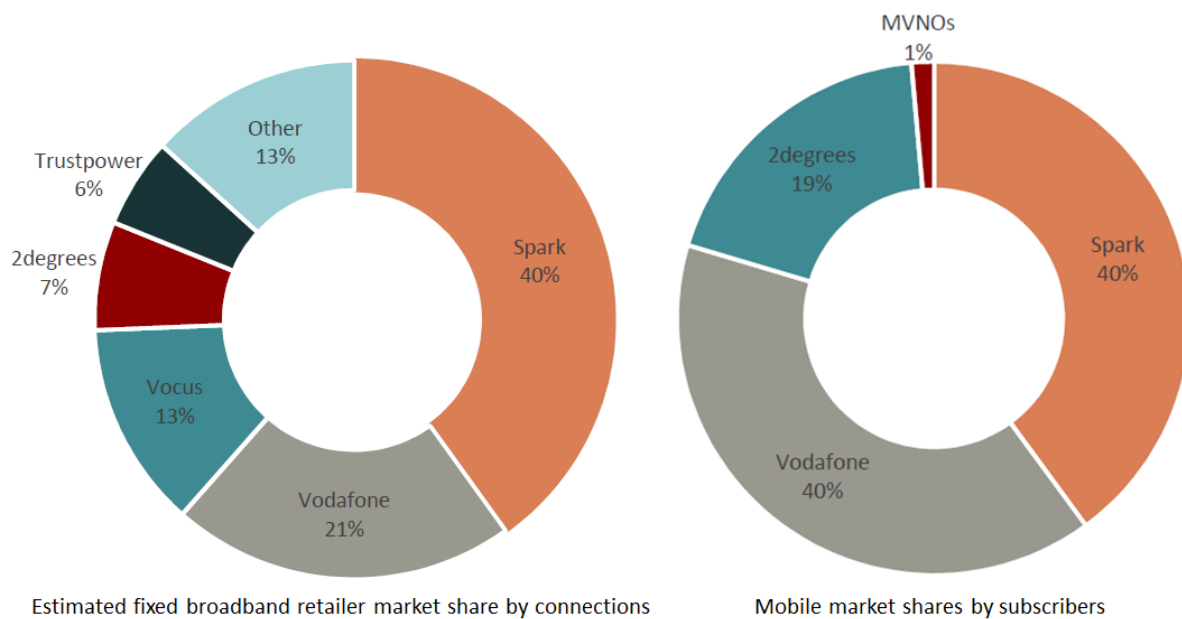
²⁸ Trustpower will retain a small number of commercial and industrial customers.

Retail market for telecommunications services

Current situation

157. As shown in Figure 16 below, Trustpower is the fifth largest broadband retail service provider with a market share of 6 per cent of connections according to the latest Commerce Commission Annual Telecommunications Monitoring Report (Commerce Commission, 2021, p. 25). Firms with greater levels of market shares were: Spark, Vodafone, Vocus and 2degrees. The Commerce Commission’s previous annual monitoring report (Commerce Commission, 2020, p. 20) also showed Trustpower holding a 6 per cent share of broadband connections. These two reports indicate that 2degrees overtook Trustpower to become the 4th largest provider between 2019 and 2020 and that Trustpower’s share has been static in the last couple of years.
158. Trustpower offers fibre and copper broadband, fixed wireless, voice and mobile (MVNO) telecommunications services to 109,000 customers (Trustpower Retail, 2021, p. 5).

Figure 16 Trustpower broadband and mobile market shares



Source: Commerce Commission (2021). Annual Telecommunications Monitoring Report. pp 25-26

159. The right hand side of Figure 16 does not separate out Trustpower’s 2020 share of mobile subscribers; instead its share is aggregated with four other MVNOs (Compass, Kogan Mobile, Vocus, and Warehouse Mobile). Trustpower launched its mobile services in July 2020 and currently has around 5,000 mobile subscribers on its MVNO with Spark (Trustpower Retail, 2021, pp. 16, 20). As Mercury does not compete in the mobile market, the transaction would not result in any aggregation in the mobile retail market.
160. The transaction would aggregate Trustpower’s 109,000 broadband, fixed line and mobile customers with the 20,000 customers served by Mercury’s NOW New Zealand. This aggregation could not result in a substantial lessening of competition in the residential broadband market as

the aggregated market share is too small. As an entity with a small share of the broadband market, Mercury would be competing against well-resourced and established entities.

Bundling

161. Trustpower offers a bundled service to its mass-market retail customers; currently a customer can choose to purchase electricity, gas and broadband from Trustpower. Mercury has indicated that the acquisition will help it expand its offer of a bundled retail service for mass-market customers.²⁹
162. Bundling is common place in workably competitive markets. For example, vehicle manufacturers now bundle heaters and radio systems with the vehicle, whereas in the past a car could be purchased without these features. In another example, shoes are sold as pairs and with laces; laces can also be purchased without buying a shoe, but it is unlikely that a retailer would sell new shoes at a lower price without laces if the consumer wished to purchase laces elsewhere. Bundling can reduce transaction costs for consumers—for example, having only one invoice to pay—and systems costs for retailers.
163. In its determination on the Vodafone/Sky proposal (Commerce Commission, 2017, p. 55) the Commission identified the potential for bundling to result in competitive harm. The Commission considered that competitive harm could occur if a firm bundled a product sold in a market in which it had market power, with a product sold in a competitive market, and offered the bundle at a discount. If rivals were unable to match that firm's bundled offering, they could be foreclosed from supplying the competitive product to customers who also wished to buy the product over which the firm had market power.
164. The circumstances described by the Commission in its Vodafone/Sky decision would not arise post Mercury's acquisition of Trustpower's mass-market retail business. As discussed above, Mercury retails to mass-market customers in the national electricity, gas and broadband markets. It does not have market power in any of these markets that it could leverage into another market by bundling services. Mercury would not supply a unique or essential part of a bundled retail service as there are other suppliers of electricity, gas, broadband and mobile services. Mercury would continue to face substantial constraints from competitors in the retail markets for all these services.
165. Mercury's competitors are also in a position to offer a bundle of energy and broadband as Contact, Nova and Vocus have done. If post acquisition a Mercury bundle of electricity, gas, broadband and mobile were to become attractive for consumers, there appear to be few barriers to its rivals creating a similar bundle as the Commission noted in its Infratil and Vodafone New Zealand decision (Commerce Commission, 2019(b), p. 21). Mercury's competitors could achieve a similar bundle by seeking an MVNO with Spark, Vodafone or 2degrees.

²⁹ <https://www.rnz.co.nz/news/business/445193/mercury-nz-plans-to-buy-trustpower-s-retail-business-for-441m>

166. Trustpower customers in the Tauranga and Western Bay of Plenty who receive the TECT rebate would be transferred to Mercury. If Mercury chooses to offer a bundled service to these customers, there would be no change in the competitive dynamic between the factual and the counterfactual, as Trustpower currently offers a bundled service to its customers benefiting from the TECT rebate.

Conclusion

167. We consider the following markets are relevant for the analysis of the competitive effects of Mercury's acquisition of Trustpower's mass-market retail operations:
- the national market for retailing electricity to mass-market customers
 - the North Island market for retailing reticulated gas to mass-market customers
 - the national market for retailing broadband to mass-market customers.
168. We assessed the transaction against a counterfactual scenario whereby, absent the transaction, Trustpower would retain its mass-market retailing business.
169. We conclude that:
- the large number of retailers in the electricity retail market, the ease of entry, the level of customer switching between competing retailers, and the ongoing implementation of regulatory initiatives to support small retailers and consumer switching, means Mercury's acquisition of Trustpower's mass-market electricity retail business is unlikely to substantially lessen competition in the national market for retailing electricity to mass-market customers
 - the North Island market for reticulated gas would be characterised post acquisition as having three large retailers—Genesis, Contact and Nova—and smaller new entrant retailers competing with Mercury across all gas networks, sustained customer switching levels, low barriers to entry as evidenced from entry and growth of new competitors in recent years; the acquisition by Mercury of Trustpower's gas retail customers would not result in a substantial lessening of competition in this market
 - the transaction could not result in a substantial lessening of competition in the residential broadband market as the aggregated market share is too small.
170. For completeness, we separate out for further analysis the GXPs and gas gates where Mercury and Trustpower's combined share of ICPs would exceed 45 per cent. We assess whether there are any network limits or other constraints that might reduce competition at these locations relative to the competitive pressure being experienced in the national retail market:
- The transaction is likely to be pro-competitive for electricity retail customers on the West Coast as it will ameliorate the current situation where a retailer wishing to compete with Trustpower on the West Coast may need to contract with Trustpower if it wishes to cover locational price risk (due to weaknesses in the transmission grid).
 - There are no physical constraints of any significance that impede competing retailers from entering or expanding their share of electricity customers in the King Country, Bay of Plenty, and Auckland regions, nor are there constraints on competition for gas customers in the Bay of Plenty; the transaction is therefore unlikely to substantially lessen competition in these locations.
171. The TECT is proceeding with a restructure that will mean Trustpower customers as at 28 January 2021 will continue to receive the rebate if they remain with Trustpower or with the entity that acquires Trustpower's retail business (in this case, Mercury). As the entitlement to the rebate is

not changed by the transaction, any competitive effects of the rebate are not altered by the transaction.

172. We also considered any potential impact in the wholesale electricity and gas markets. We conclude that the size of the initial change in risk profile of each entity in the wholesale markets is not sufficient to change the behaviour of either party in the wholesale electricity, electricity derivatives, ancillary services or wholesale gas markets.
173. The circumstances described by the Commission in which bundling could result in competitive harm would not arise in any bundling by Mercury post its acquisition of Trustpower's mass-market retail business. Mercury does not have market power in any relevant market that it could leverage into another market by bundling services.
174. In short, we conclude that Mercury's acquisition of Trustpower's mass-market electricity, gas, fixed and wireless broadband, and mobile phone services retail operations would not result in a substantial lessening of competition in any market. The transaction may result in increased competition in electricity retailing on the West Coast.

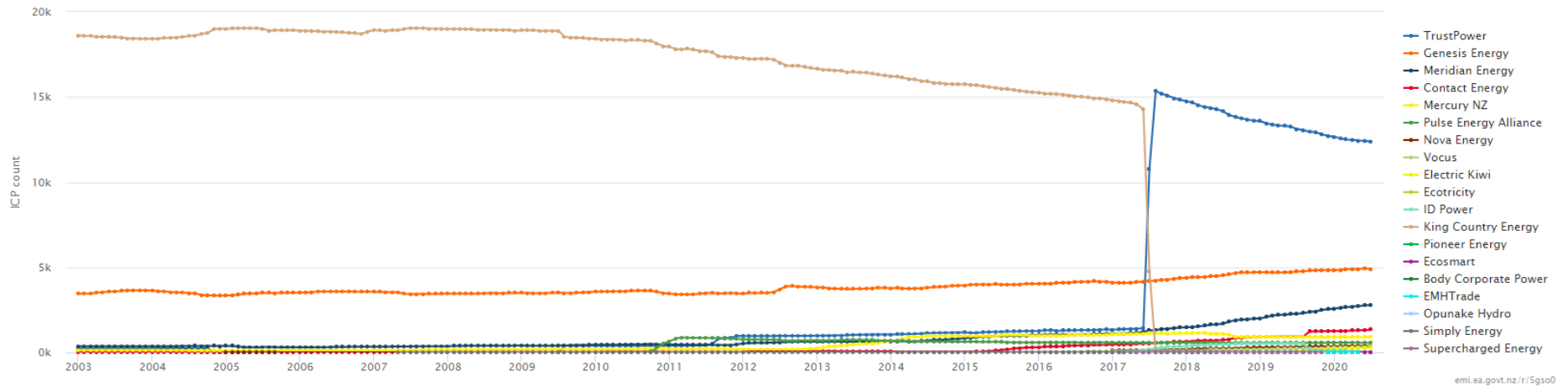
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Appendix A

Figure 12 Market share trend in the King Country



Source: <https://emi.ea.govt.nz>

About Sapere

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