COMMERCE COMMISSION NEW ZEALAND

July 2013

Mergers and Acquisitions Guidelines

This document should be read in view of amendments to the Commerce Act and the Commerce Act (Fees) Regulations made in August 2017. The Commission will update the document in the near future to reflect changes made under the Act.

Contents

Introduction by the Chairman

Since the substantial lessening of competition test for mergers was introduced in 2001, and we published the first Mergers and Acquisitions Guidelines in 2003, significant case-law developments have clarified how the merger test and the merger clearance regime apply.

Our thinking has also evolved as new issues have come before us, and as we have assimilated changing international scholarship, research and jurisprudence on antitrust issues.

Our written merger decisions will always give the most contemporaneous guidance to our assessments. But our aim for these revised guidelines is that they will capture the relevant developments to date in one place.

We have sought to draft the guidelines in plain English. The result is that much of the text from the 2003 guidelines has changed. However, for the most part, this does not signal substantive change. Rather, it simply reflects our wish to make the guidelines more user-friendly and understandable for businesses and their advisors.

That said, we have made some changes that are worth highlighting.

How we assess what will likely happen without the merger – counterfactual analysis

We have explained in detail how we assess when a substantial lessening of competition will be likely, applying the approach of the Court of Appeal in The Warehouse case.[1]

Conditions of entry and expansion

We have emphasised that our focus is on conditions of entry and expansion and their role in influencing the likelihood, extent and timeliness of entry and expansion by existing or new competitors (the LET test).

This change reflects the courts' own move away from the language of 'barriers' to entry and expansion to the term 'conditions' – a more expansive concept.[2]

Market definition is a tool to aid the competition analysis, not an end in itself

New Zealand courts have reiterated that market definition is a tool to aid in competition analysis, rather than an end in itself. We have adopted this approach in these guidelines. In particular we have moved away from defining markets as a first step in the analysis and recognise that relevant markets need not always be defined precisely.

Mergers between competing buyers

On a number of occasions over the past few years we have assessed mergers between competing buyers. As there was only a limited discussion of buying side mergers in the 2003 guidelines, we have included a more detailed explanation of how we assess mergers between competing buyers.

1. *Woolworths Ltd & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) and *Commerce Commission v Woolworths Ltd & Ors* (2008) 12 TCLR 194 (CA).
2. *Air New Zealand/Qantas v Commerce Commission* (No 6) (2004) 11 TCLR 347 (HC) at [102] and *New Zealand Bus Ltd v Commerce Commission* [2008] 3 NZLR 433 (CA) at [252].

The role of efficiencies

Our guidelines clarify our analytical approach to efficiencies. It remains a rare case in which efficiencies would be sufficient to prevent a substantial lessening of competition. A merger which relies on efficiencies is better dealt with under the authorisation regime, and we continue to encourage applicants to use that process for such mergers.

Other changes

Two other changes prompted comments and questions from interested parties, during our consultation on the draft guidelines.

The first is the change in language from 'market share safe harbours' to 'concentration indicators'. This is not a change in substance. Rather, it reflects the fact that the term 'safe harbour' seemed to provide transacting parties with an unwarranted degree of comfort. Market share measures remain insufficient in themselves to establish whether a merger is likely to have the effect of substantially lessening competition. Such a conclusion can only be reached on a full analysis.

The second is that we no longer use the term 'maverick'. 'Maverick' was used in the 2003 guidelines as shorthand to describe a particularly aggressive competitor relative to other firms in the market or which otherwise has a destabilising effect. This underlying concept is just as relevant in these guidelines; it is just we do not use the label 'maverick'.

One-stop shop

Finally, we have made these guidelines a 'one-stop shop' by including within them the merger process guidelines, and our divestment and failing firm guidelines.

Naturally, our approach will continue to evolve just as it has since we published our 2003 guidelines, but we trust these guidelines will assist businesses to obtain a comprehensive view of our approach, and assist them in their decision making.

Mark Berry

Dr Mark Berry

Chairman

24 July 2013

Purpose of these guidelines

The purpose of these guidelines is to explain:

- how the Commerce Commission assesses whether or not an acquisition of a firm's assets or shares would be likely to substantially lessen competition in a market; and
- the process we follow when considering clearance applications.

Executive summary

X1 Mergers can bring many benefits to the New Zealand economy by making it possible for firms to be more efficient and innovative. However, some mergers also have the potential to lessen competition to the detriment of consumers.

X2 Mergers that substantially lessen competition in a market are illegal under the Commerce Act 1986 (the Commerce Act), unless they are authorised.

X3 Merging firms can apply to us for clearance or authorisation of a proposed merger.

X3.1 We will clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any New Zealand market.

X3.2 We will authorise a merger if we are satisfied that the merger would be likely to result in such a benefit to the public that it should be permitted even though it may substantially lessen competition.[3]

X4 If we clear or authorise a merger, the merger cannot be challenged under section 47 of the Commerce Act, provided it is completed within 12 months from when we grant clearance or authorisation.[4]

Substantial lessening of competition

X5 We assess mergers using the substantial lessening of competition test. This test asks whether a merger is likely to substantially lessen competition by comparing the likely state of competition if the merger proceeds with the likely state of competition if the merger does not proceed.

X6 A lessening of competition is generally the same as an increase in market power – the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),[5] or reduce non-price factors such as quality or service below competitive levels.[6]

X7 Only a lessening of competition that is substantial is prohibited under the Commerce Act. We consider a substantial lessening of competition is a lessening of competition that will adversely affect consumers in the market in a material way.

3. Our Authorisation Guidelines explain when we will authorise mergers and agreements under Part 5 of the Commerce Act and the processes we follow when considering authorisations. Available on our website at www.comcom.govt.nz/authorisation-guidelines
4. Our decisions to clear or authorise a merger can be appealed by certain persons.
5. Or below competitive levels in a merger between buyers.
6. Prices may be increased either directly by a firm or indirectly by a firm reducing output. When we refer to a price increase, the sentence should be read as including a reduction in quality, range, level of innovation, service or any other element of competition valued by buyers.

Mergers between competing suppliers

X8 A merger between competing suppliers could substantially lessen competition in a market if:

- X8.1 the merger removes a competitor that provided a competitive constraint, resulting in the ability for the merged firm to profitably increase prices; or
- X8.2 the merger increases the potential for the merged firm and all or some of its remaining competitors to coordinate their behaviour so that output reduces and/or prices increase across the market.

X9 We use market definition as a framework to identify and assess the close competitive constraints the merged firm would likely face.

X10 In defining a market we assess whether goods or services are substitutable for each other as a matter of fact and commercial common sense.

X11 Market shares and concentration measures following a merger can indicate levels of competition in a market. As such, we use market share and concentration indicators to identify those mergers that are less likely to raise competition concerns.

X12 The two indicators that a merger is less likely to raise competition concerns are:

- X12.1 where post-merger the three largest firms in the market have a combined market share of less than 70%, and the merged firm's market share is less than 40%; and/or
- X12.2 where post-merger the three largest firms in the market have a combined market share of 70% or more, and the merged firm's market share is less than 20%.

X13 The indicators are only initial guides. A merger not exceeding these indicators may still substantially lessen competition. Equally, a merger exceeding the indicators will not necessarily substantially lessen competition.

X14 Whether any merger between competing suppliers is in fact likely to lessen competition will depend on a range of factors including:

- X14.1 how likely it is that existing competitors could expand their sales or new competitors could enter the market in a way that would constrain the merged firm; and
- X14.2 whether buyers have the ability to exercise a substantial influence on the price, quality or terms of supply they receive from the merged firm.

Mergers between competing buyers

X15 Just like a merger between competing suppliers, a merger between competing buyers may substantially lessen competition if that merger gives the merged firm market power or greater market power when buying products.

X16 Buyer market power is the ability to reduce prices paid to suppliers to a level below the competitive price, leading to a decrease in output.

X17 How we analyse the impact of a merger of competing buyers largely mirrors our analysis of a merger between competing suppliers.

Mergers between firms that are not competitors

X18 A merger between firms who are not competitors (for example, at different levels of the supply chain, or between firms which sell complementary products) is less likely to result in a substantial lessening of competition than a merger between competitors. This is because such mergers do not lead to a direct loss of competition between the merging firms.

X19 However, a substantial lessening of competition is still possible if:

X19.1 the merger gives the merged firm a greater ability and/or incentive to engage in conduct that prevents or hinders rivals from competing effectively; or

X19.2 the merger increases the likelihood of coordinated behaviour among firms.

Merger clearance process

X20 These guidelines also set out how we assess applications for clearance, with the aim of completing clearance investigations as quickly and transparently as possible. This includes what to do pre-clearance, how to apply for clearance, how we investigate an application for clearance, publication of written reasons, and confidentiality.

Chapter 1. Introduction

1.1 Mergers can bring many benefits to the New Zealand economy by making it possible for firms to be more efficient and innovative. But some mergers can harm competition by increasing the merged firm's market power which could result in, for example, higher prices and reduced choice or quality for customers.

1.2 The purpose of the Commerce Act 1986 (the Commerce Act) is to promote competition in markets for the long-term benefit of consumers within New Zealand.[7] One of the ways it does this is by prohibiting any person from acquiring a firm's assets or shares if that acquisition would be likely to substantially lessen competition in a New Zealand market.[8]

1.3 Under the Commerce Act merging firms can apply to the Commission for clearance or authorisation of a proposed merger.

1.3.1 We will clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in a New Zealand market.

1.3.2 We will authorise a merger if we are satisfied that the merger would be likely to result in such a benefit to the public that it should be permitted even though it may substantially lessen competition.

1.4 Because merging firms are not obliged to seek clearance and authorisation, we monitor markets to identify potentially anti-competitive mergers where the merging firms have not sought clearance or authorisation. If we have concerns that a merger may substantially lessen competition where the firms have not sought clearance or authorisation, we may investigate that merger. If, following our investigation, we consider that the merger is likely to substantially lessen competition, we take appropriate enforcement action. This may include seeking an order to stop the merger from occurring, seeking orders requiring the acquirer to divest some of its assets (eg, the assets or shares it has acquired), and/or seeking a penalty.

1.5 These guidelines explain how we assess whether a merger substantially lessens competition, and the process we follow when considering applications for clearance.

1.6 As these guidelines are (by their nature) general, we apply them flexibly according to the facts of each merger. These guidelines do not, and cannot, address every issue that might arise from a merger, so anyone contemplating a merger should consider seeking legal advice.

1.7 These guidelines also reflect the current state of the law, international thinking and developments, and our own experience. Our approach will, therefore, continue to evolve in light of new developments.

7. Commerce Act 1986, s 1A.
8. Commerce Act 1986, s 47.

1.8 These guidelines contain six sections and six attachments.

1.8.1 Section 1 is this introduction.

1.8.2 Section 2 describes the legal framework for the substantial lessening of competition test, and the clearance regime for mergers.

1.8.3 Section 3 explains how we assess whether a merger between competing suppliers is likely to substantially lessen competition.

1.8.4 Section 4 explains how we assess whether a merger between competing buyers is likely to substantially lessen competition.

1.8.5 Section 5 explains how we assess whether a merger between parties that are not competitors is likely to substantially lessen competition.

1.8.6 Section 6 explains the merger clearance process.

1.8.7 Attachment A is a glossary.

1.8.8 Attachment B sets out documents and other information that we can find useful in assessing whether mergers substantially lessen competition.

1.8.9 Attachment C explains how we assess partial acquisitions.

1.8.10 Attachment D sets out an example of how we calculate our market share and concentration indicators.

1.8.11 Attachment E explains how we assess ‘failing firm’ arguments and types of information that applicants should provide to support such submissions.

1.8.12 Attachment F explains how we assess whether divestment undertakings may remedy competition concerns arising from a merger in the context of a clearance application.

Chapter 2. Legal framework for mergers

2.1 The Commerce Act prohibits any person from acquiring the assets of a business or shares in a business, if that acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.[9] This is known as the 'substantial lessening of competition test'.

2.2 The substantial lessening of competition test applies to all mergers. This includes mergers which take place outside New Zealand involving non-New Zealand firms, provided the merger affects a market in New Zealand.[10] [11]

2.3 This section explains the concepts used in the substantial lessening of competition test and the legal framework for the clearance and authorisation regimes.

Person, interconnected corporate entities, and associated persons

2.4 The Commerce Act defines a person to include a local authority, and any association of persons whether incorporated or not.[12] The Commerce Act applies to privately-owned firms, state-owned enterprises and Crown corporations,[13] as well as to the Crown when the Crown is engaged in trade.[14]

2.5 For the purposes of the substantial lessening of competition test in a merger context, a person can include two or more persons that are interconnected or associated.[15] Two corporate entities are interconnected if:[16]

2.5.1 one is a parent company and the other a subsidiary;[17]

2.5.2 the two corporate entities are subsidiaries of the same parent company; or

2.5.3 the two corporate entities are interconnected with other corporate entities that are themselves interconnected.

9. Commerce Act 1986, s 47(1).
10. Commerce Act 1986, s 4.
11. It also applies when a person acquires less than 100% of the shares in a company, an issue discussed in Attachment C.
12. Commerce Act 1986, s 2(1A).
13. Commerce Act 1986, s 6.
14. Commerce Act 1986, s 5.
15. Commerce Act 1986, s 47(2).
16. Commerce Act 1986, s 2(7).
17. A subsidiary has the same meaning as set out in the Companies Act 1993.

2.6 Two corporate entities are associated if one can exert a substantial degree of influence over the activities of the other, either directly or indirectly.[18] The Commerce Act provides no guidance on when a person has a substantial degree of influence over another.[19]

2.7 We consider that a person (A) has a substantial degree of influence over another person (B), if person A has the ability to bring real pressure to bear on the decision-making process of person B.[20] This is because, if one party can substantially influence the activities of the other, it may not be appropriate to regard each of those parties as separate competitors in the market.

2.8 Whether a person has a substantial degree of influence over another is a question of fact. In making this assessment we consider a number of factors, including:

2.8.1 the nature and extent of ownership links between the companies;

2.8.2 the presence of overlapping directorships;

2.8.3 the rights of one company to appoint directors of another;

2.8.4 the nature of other shareholder agreements and other links between the companies concerned (including family or financial links);[21] and

2.8.5 the nature and extent of the communications between the persons, and the apparent influence of one person on the key strategic decisions of the other.[22]

2.9 In relation to ownership links, a substantial degree of influence can arise at any level of shareholding. Shareholdings of less than 50% can still enable a person to influence the competitive behaviour of another person. In this respect, the spread of shareholdings in a firm is relevant. For example, a shareholder may have a substantial degree of influence on a firm if it has a shareholding of 10% in the firm and the balance of the shareholding in the firm is a mix of smaller shareholders.

18. Commerce Act 1986, ss 47(3)-(4).
19. The Act's definition of 'substantial' as meaning 'real or of substance' does not apply in the context of 'substantial influence' (Commerce Act 1986, s 2(1A)).
20. See, for example, *Commerce Commission v New Zealand Bus Ltd* (2006) 11 TCLR 679 (HC) at [209]-[214].
21. We may also take into account the extent to which parties have acted together in concert, ie, despite no formal ownership arrangements, as evidence of whether one has a substantial degree of influence over another.
22. See, for example, Visy and HPNZ [2012] NZCC 9.

Acquiring assets of or shares in a business

2.10 The substantial lessening of competition test applies where a person acquires assets of a business or shares.

Assets of a business

2.11 Assets include both physical and intangible assets. Intangible assets include goodwill, patent rights and other intellectual property, contractual rights such as options, franchises or some management contracts, operational know-how, and customer lists.

Shares

2.12 Under the Commerce Act share means a share in a company or other body corporate, whether or not the share carries a right to vote at a general meeting.[23] A share also includes:

2.12.1 a beneficial interest in any such share;

2.12.2 a power to exercise, or control the exercise of, a right to vote at meetings of the company;

2.12.3 a power to acquire or dispose of, or control the acquisition or disposition of, any such share; and

2.12.4 a perpetual debenture and perpetual debenture stock.

2.13 Under this definition, the Commerce Act applies to the acquisition of an equitable interest in shares as well as the acquisition of any legal interest. For example, acquiring a put or call option over shares may be an acquisition of shares.[24]

Acquire

2.14 The Commerce Act defines acquire widely.[25] In relation to goods, it includes to obtain by way of gift, purchase or exchange, lease, hire or hire purchase. In relation to services, it includes to accept.

2.15 While a person may acquire the assets of a firm, or shares in a firm, in a number of ways, exactly how a person acquires the assets or shares is not usually relevant to whether that acquisition would be likely to substantially lessen competition.[26]

23. Commerce Act 1986, s 2(1).

24. Given the voluntary nature of the regime, it is up to each merging party to decide whether the acquisition of an equitable or beneficial interest requires clearance. Further information on acquisitions that involve a firm acquiring partial ownership and/or control can be found in Attachment C.

25. This includes if a person is issued shares by a company.

26. Commerce Act 1986, s 66(1).

Conditional contracts

2.16 The Commerce Act provides that a clearance can only be obtained when an acquisition is 'proposed', ie, not completed.[27]

2.17 Where a merger is conditional on clearance or authorisation, we do not consider that a person has acquired an equitable or legal interest in the relevant assets or shares at that time.[28] Where a merger is conditional on matters other than clearance or authorisation, a person may have acquired an equitable interest, depending on the terms of the contract itself.

27. Commerce Act 1986, s 66(1).

28. In *NZ Bus v Commerce Commission* [2008] 3 NZLR 433 at [29] (CA) Hammond J found that "…on the waiver [of the condition in the agreement to seek clearance/authorisation], the agreement between NZ Bus and Mana became unconditional and NZ Bus acquired an equitable interest in the shares of Mana".

Substantial lessening of competition

2.18 Competition is the process through which firms compete to win customers based on price, quality, service or any other dimension of competition. This includes innovation competition between firms to introduce demand-enhancing new products or cost-reducing production processes.[29] In these guidelines we use the term 'price' as shorthand for all dimensions of competition, including quality, range, level of innovation, service or any other element of competition valued by buyers.[30] We also use 'product' as shorthand for goods and services.

2.19 The substantial lessening of competition test exists to protect the competitive process.[31] It is not focused on protecting individual firms.[32]

2.20 The substantial lessening of competition test is a relative standard. We ask whether the merged firm's market power would increase relative to the merged firms' market power without the merger[33] (the with and without test is discussed further below). That is, has the firm's market power moved along the spectrum away from perfect competition towards monopoly?[34] Market power is the ability to raise price profitably and sustainably above competitive levels.[35]

2.21 A lessening of competition (which includes a hindering and/or prevention of competition)[36] – or an increase in market power – may manifest in a number of ways, including higher prices or reduced services.

2.22 Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[37] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[38]

2.23 Consequently, no bright line separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.[39]

29. Whether a merger lessens innovation competition will depend on the facts of the case. We take into account factors such as: the importance of the merging firms in driving innovation, the importance of the remaining firms in the market in driving innovation; and how the ability and incentives of the merging firms to innovate differ with and without the merger, eg, whether the merging firms bring together complementary or substitutable goods and skills.
30. Prices may be increased either directly by a firm or indirectly by a firm reducing output.
31. Competition is defined as workable or effective competition. Commerce Act 1986, s 3(1).
32. *ANZCO Foods Waitara Ltd v AFFCO NZ Ltd* [2006] 3 NZLR 351 (CA) at [242].
33. The test captures the creation, preservation and enhancement of market power.
34. *Air New Zealand/Qantas v Commerce Commission (No 6)* (2004) 11 TCLR 347 (HC) at [42], cited with approval in W*oolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [110].
35. Or below competitive levels in a merger between buyers.
36. Commerce Act 1986, s 3(2).
37. *Woolworths & Ors v Commerce Commission* (HC) above n 34 at [127].
38. *Woolworths & Ors v Commerce Commission* (HC) above n 34 at [129].
39. Where the lessening of competition manifests in price increases, the High Court has indicated that a price increase of 4–5% provides a general guide as to a price increase that would indicate a 'substantial' lessening of competition. The Court also noted that price increases of less than 4% can be sufficient to amount to a substantial lessening of competition. *Woolworths & Ors v Commerce Commission* (HC), above n 34 at [145] and [156].

2.24 We make our judgement having regard to the Commerce Act's purpose to promote competition in markets for the long term benefit of consumers. Ultimately, therefore, we ask whether competition will be substantially lessened on the basis of whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

2.25 A lessening of competition does not need to be felt across an entire market, or relate to all dimensions of competition in a market, for that lessening to be substantial. A lessening of competition that adversely affects a significant section of the market may be enough to amount to a substantial lessening of competition.[40]

40. *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 64 FLR 238; ATPR 40-315, 43,888.

Likely effect of substantially lessening competition

2.26 To be prohibited, a merger must have the effect, or likely effect, of substantially lessening competition. As we can only grant clearances for mergers that have not yet occurred, these guidelines focus on the likely effect of a merger.

2.27 A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility, but does not mean that the effect needs to be more likely than not to occur (ie, it does not need to have a greater than 50% probability of occurring).[41]

2.28 Whether the substantial lessening of competition is likely is a matter of judgement based on the evidence.

The with and without test

2.29 To assess whether a substantial lessening of competition is likely requires us to compare the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual); with the likely state of competition if it does not (the scenario without the merger, often referred to as the counterfactual); and determine whether competition would be substantially lessened comparing those scenarios.[42]

How we assess what is likely to occur without the merger

2.30 As something can be likely even when the chance of it occurring is less than 50%, there may be multiple scenarios that are likely without the merger (and with the merger).

2.31 We first assess the possible scenarios that might arise without the merger and discard those that are unlikely. We then compare the state of competition in each likely scenario without the merger, to the likely state of competition with the merger.

2.32 If competition would be substantially lessened in the scenario with the merger compared to any one of those likely states of competition without the merger, then the merger will have a likely effect of substantially lessening competition.[43]

2.33 As a practical matter, we usually focus our analysis on the likely without-the-merger scenario we consider the most competitive. Doing so means our analysis is based on a worst case scenario, in the sense that it is the scenario that would give rise to the greatest competition concerns. We do this because if the merger is unlikely to substantially lessen competition compared to this worst case scenario, then it is unlikely to substantially lessen competition when compared to any other likely scenario.

2.34 If we are not satisfied that competition would not be substantially lessened, compared to any of the scenarios likely to arise without the merger, we must decline clearance.

41. *Woolworths & Ors v Commerce Commission* (HC) above n 34 at [111].

42. *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63]. Our view is that the test set out by the High Court in Woolworths does not incorporate the concept of likelihood twice. That is we do not assess whether competition is likely to be substantially lessened comparing the likely state of competition with the merger and without the merger.

43. *Woolworths & Ors v Commerce Commission* (HC) above n 34 at [122] and *Commerce Commission v Woolworths Limited* (CA) above n 42 at [63].

2.35 We make a pragmatic and commercial assessment of what is likely to occur in the future with and without the merger. This assessment is based on the information we obtain through our investigation and takes into account factors including market growth and technological changes.

2.36 Often the best guide of what would happen without the merger is what is currently happening (ie, the status quo). However, where a market is likely to undergo changes that will affect competition in the without-the-merger scenario, we take these changes into account.[44]

2.37 For example, the status quo may not provide a good guide as to the future state of the market if the target firm is failing. Further information on how we assess whether a firm is failing can be found in Attachment E.

2.38 Another example would be where, without the merger, one of the merging firms was planning on developing a product to compete with the other merging firms. In such a case, the state of competition without the merger should reflect this development.

2.39 Finally, a merger is often the result of a contested sales process. In such a situation we take this sales process into account in assessing the likely without-the-merger scenario.

2.40 In general, if there is an alternative buyer but the acquisition by that party might give rise to competition concerns, then we are unlikely to adopt that situation as the without scenario. This is because such a merger would be unlikely to occur without a clearance or intervention from us.[45]

Clearance and authorisation regime for mergers

2.41 A person proposing to undertake a merger may apply to us for a clearance or an authorisation of the proposed merger. This is a voluntary regime; there is no statutory requirement to seek clearance or authorisation.

2.42 We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[46] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.[47]

2.43 Where there are competition concerns, an applicant can provide an undertaking to sell certain assets or shares as a condition of clearance in order to remedy those competition concerns.[48] More information on undertakings is contained in Attachment F.

44. Like all future market developments, if a parallel transaction is likely to occur which will affect competition, we will take that into account when assessing the likely future state of competition.

45. Where we consider that the sale to a credible competing buyer is a likely scenario without the merger, we will usually consider the state of competition to be the status quo, unless there is reason to consider that some different state of competition is likely given a new owner of the relevant assets or shares.

46. Commerce Act 1986, s 66(1).

47. In *Commerce Commission v Woolworths Limited* (CA), above n 42 at [98], the Court held that “the existence of a ‘doubt’ corresponds to a failure to exclude a real chance of a substantial lessening of competition”. However, the Court also indicated at [97] that we should make factual assessments using the balance of probabilities.

48. Commerce Act 1986, s 69A.

2.44 Alternatively, a person can apply for an authorisation. We will authorise a merger if, despite any competition concerns,[49] we are satisfied that the merger would be likely to result in such a benefit to the public that it should be permitted. As with a clearance, if we are not satisfied, we must decline to authorise the merger.[50]

2.45 If we clear or authorise a merger and the merger is carried out within one year of the date on which it is cleared, the merger cannot be challenged in the High Court on the grounds that it substantially lessens competition.[51]

2.46 Merging firms can proceed with a merger without seeking clearance or authorisation. However, if we consider that a merger substantially lessens competition or would be likely to, we can file High Court proceedings alleging a breach of the Commerce Act. A third party can also take High Court action.

2.47 If we become aware of such a merger before it is completed, we are likely to seek urgent interim relief from the High Court to prevent the merger going ahead. We would do this to preserve competition in the market until the High Court has had an opportunity to consider whether the merger is in fact likely to substantially lessen competition.[52]

2.48 If we do commence proceedings, it is for the High Court to decide whether the merger is likely to substantially lessen competition.

2.49 Where the High Court considers that a merger does, or is likely to, substantially lessen competition, the Court can order various remedies, such as:

2.49.1 a pecuniary penalty of up to $5 million for a body corporate, or $500,000 for an individual;

2.49.2 an order requiring the person to dispose of any assets or shares specified by the Court;

2.49.3 an injunction restraining the person from completing the merger; and/or

2.49.4 an award of damages.

2.50 Damages are only available to third parties, while pecuniary penalties and divestment orders are only available to the Commission. Any person can seek an injunction to prevent a merger.

2.51 Where we determine to clear or authorise a merger or decline to do so, the determination can be appealed by the merging firms, or any person who participated in a conference held by us in relation to the clearance or authorisation.[53]

49. For mergers, where we receive an authorisation application, we must first assess whether to grant clearance. We will clear the merger if we are satisfied that the merger will not have, or would not be likely to have, the effect of substantially lessening competition in a market.

50. For more information on when we will authorise mergers and agreements and our authorisation process, see our Authorisation Guidelines.

51. Where a party appeals a determination and the High Court grants clearance, the relevant timeframe is 12 months from the date on which the High Court grants clearance.

52. Alternatively we may seek a Cease and Desist Order from the Cease and Desist Commissioner.

53. Commerce Act 1986, s 92(c). We rarely hold conferences for clearance applications (see footnote 129 below).

Chapter 3. How we assess mergers between competing suppliers

3.1 Where two suppliers compete in the same market, a merger between them would eliminate the competition between them. This does not necessarily mean that the merger would be likely to substantially lessen competition in the market.

3.2 Competition is the process through which firms compete to win customers based on price, quality, service or any other dimension of competition. This includes innovation competition between firms to introduce demand-enhancing new products or cost-reducing production processes.[54] In these guidelines we use the term 'price' as shorthand for all dimensions of competition, including quality, range, level of innovation, service or any other element of competition valued by buyers.[55]

3.3 In brief, a merger between competing suppliers could substantially lessen competition in one or more of the following ways.

3.3.1 The merger removes a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses. This is referred to as 'unilateral effects'.

3.3.2 The merger increases the potential for the merged firm along with some or all of the remaining competitors to coordinate their behaviour so that prices increase in the market. This is referred to as 'coordinated effects'.[57]

3.4 In this section we describe how we assess whether a merger between competitors is likely to substantially lessen competition in a market. This includes:

3.4.1 why and how we define markets;

3.4.2 our market share and concentration indicators – which are to help merging firms assess whether a merger is likely to substantially lessen competition – and how we measure market shares;

3.4.3 how we assess whether a merger would or would be likely to result in unilateral and/or coordinated effects.

54. Whether a merger lessens innovation competition will depend on the facts of the case taking into account: the importance of the merging firms in driving innovation, the importance of the remaining firms in the market in driving innovation; and how the ability and incentives of the merging firms to innovate differ with and without the merger, eg, whether the merging firms bring together complementary or substitutable goods and skills.

55. Prices may be increased either directly by a firm or indirectly by a firm reducing output.

56. We take into account constraints including existing competition, entry and expansion, and countervailing power.

57. This includes coordination without any explicit communication between the parties ('tacit collusion'), such as price signalling.

3.5 This section also explains specific factors relevant to our assessment of whether unilateral or coordinated effects arise, namely:

3.5.1 how we assess whether existing competitors can expand their sales, or new competitors can enter and effectively compete with the merged firm;

3.5.2 how we assess whether buyers can exercise countervailing power (or, in the case of potential buyer market power concerns, suppliers);

3.5.3 the role of efficiencies in our assessment; and

3.5.4 the impact of firms' ownership on their incentives.

3.6 Attachment B sets out documents and other information that we find useful in assessing these issues.

Why and how we define a market

3.7 Market definition is a tool that provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.[58] It encompasses actual and potential transactions between sellers and buyers, and seeks to capture the factors that directly shape and constrain rivalry between sellers.[59]

3.8 A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of "fact and commercial common sense".[60]

3.9 In general, the more closely substitutable two products are, the closer the competition and the greater the competitive constraint between those products.

3.10 We define markets in the way that best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market.

3.11 There may not be a bright line that separates those products that are within a market from those outside that market. A product may compete more closely (be a closer substitute) with some products than with others. This is particularly the case where products are differentiated, such as with branded products.

3.12 What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products which fall outside the market but which still impose some degree of competitive constraint on the merged firm.[61]

3.13 Where a number of markets exhibit similar competitive characteristics, we may, for ease of reference, refer to them as a single class of market for the purposes of the competition assessment. We may also define markets for a bundle of products where this would best illustrate the competitive constraints the merged firm would likely face.[62]

3.14 Below we explain how we define a market. In general, we assess substitution possibilities across up to five different dimensions, namely:

3.14.1 the products supplied and purchased (the product dimension);

3.14.2 the geographic area from which the products are obtained, or within which the products are supplied (the geographic dimension);

3.14.3 the level in the supply chain at which the parties operate (the supply chain level dimension);

3.14.4 the different customer types (the customer dimension); and

3.14.5 the time period within which the market operates (the time dimension).

58. *Commerce Commission v New Zealand Bus Limited* (HC), above n 20 at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

59. *Commerce Commission v Air New Zealand Ltd et al* (2011) 9 NZBLC 103,318 (HC) at [124].

60. Similarly, the courts have said that "[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices". See *Commerce Commission v New Zealand Bus Limited* (HC), above n 20 at [123] citing Re *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

61. *Brambles New Zealand Ltd v Commerce Commission*, see n 58 above, (HC) at [34]-[39] and [157]-[159].

62. For example, where customers buy a bundle containing multiple product components. An example of this that we have investigated is electric fencing systems. See Gallagher Holdings Ltd and Tru-Test Corporation Ltd (Commerce Commission Decision 531, 26 August 2004). When we consider bundles we may assess the impact of the merger by bundle rather than by individual product component. This is particularly the case where the competitors' product components are not interoperable with one another or market shares and competitive characteristics are similar across the bundled product components.

How we assess substitution and the boundaries of the relevant market

3.15 Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market. We ask the same question for each of the five market dimensions.

3.16 We consider substitution by both customers and suppliers and ask, if prices increased, whether:

3.16.1 customers would switch sufficient purchases to alternative products or locations (customer or demand-side substitution); or

3.16.2 firms would easily, profitably and quickly (generally within one year) switch production to the products or locations in question without significant cost[63] (supplier or supply-side substitution). We call these firms 'near competitors'.

3.17 We use the hypothetical monopolist test as a conceptual tool to help us answer the first of these questions.[64] We explain how we approach the second of these questions briefly further below (see paragraphs 3.27 and 3.38-3.39).[65]

3.18 This test asks whether a hypothetical sole supplier of a set of products (or locations) would profitably increase prices for at least one of the merging firms' products (or locations) by at least a small, but significant, amount.[66] This small, but significant, amount is often referred to as a SSNIP – a small, but significant, non-transitory increase in price. We generally use 5% as the SSNIP.

3.19 In general, the smallest set of products (or locations) in which the SSNIP can be profitably sustained is defined as the relevant product (geographic) market.

3.20 Using the product market dimension as an example,[67] we apply the hypothetical monopolist test by starting with the narrowest possible market in which the merged firm would supply at least one product.

3.20.1 If the hypothetical monopolist would be able to profitably increase the price of at least one of the products supplied by the merged firm by a SSNIP, then this is in general the relevant market.

3.20.2 If the hypothetical monopolist could not profitably impose a SSNIP because customers would switch sufficient purchases to alternative products, then we widen the market to include the next best substitute and reapply the test. We repeat this process until it would be profitable for the hypothetical monopolist to impose a SSNIP.

63. To be a near competitor, a firm must be able to enter a market with little or no investment, and, in particular, without incurring significant sunk costs. Sunk costs are costs a firm incurs on entry and which it would not be able to recover if it later exits the market, eg, various start-up costs such as developing and testing products, installing equipment, and advertising and marketing. Sunk costs can make entry more challenging because a firm, when entering, will take into account what costs it would be likely to recoup if it exited. The greater the sunk costs, the greater the risk faced by a person contemplating entry into the market.

64. The hypothetical monopolist test is not mandated by the Commerce Act and, being a tool, we may not always be able to apply it with confidence. *Brambles New Zealand Ltd v Commerce Commission*, above n 58 at [81].

65. Although we discuss supplier substitution below in relation to only geographic and supply chain dimensions, it can be relevant to each dimension of market definition.

66. The test assumes that all other prices are held at current levels.

67. We explain how we apply the hypothetical monopolist test to the geographic dimension of the market below at paragraphs 3.28-3.34.

3.21 In applying the hypothetical monopolist test, we generally use prevailing market prices as our starting point and apply a SSNIP to those prices. However, in cases where the evidence suggests that future prices (without the merger) are likely to be different from current prices, we would use the likely future prices.

3.22 Finally, in some markets, suppliers may be able to identify and charge different prices to different customers where those price differences are not related to differences in the costs of serving those customers.[68] This is referred to as 'price discrimination'.

3.23 Price discrimination may result in narrower customer, geographic or temporal dimensions to the market than would otherwise be the case if:

3.23.1 different customers have different supply alternatives;

3.23.2 a supplier can identify customers with differing abilities to switch to alternative suppliers; and

3.23.3 customers cannot acquire the product from customers who paid a lower price.[69]

3.24 While often the hypothetical monopolist test cannot be quantitatively applied, it nevertheless provides a useful way of analysing the evidence and judging the extent of substitution between products or locations.

Defining the product dimension of a market

3.25 In assessing the product dimension we look for evidence showing which products customers regard as close substitutes, and whether they would switch sufficient purchases to those products to make a SSNIP unprofitable.

3.26 We consider the extent to which customers have previously switched between products in response to changes in price. We also consider:

3.26.1 the function or end use of the product;

3.26.2 the product's characteristics;

3.26.3 sales, pricing and marketing strategies, and behaviour of both the merging firms and of suppliers of potential substitute products;

3.26.4 customer preferences; and

3.26.5 the costs customers face in switching between suppliers ('switching costs'), including, for example, costs arising from switching away from any long-term supply contracts.

3.27 In terms of supplier substitution, we consider:

3.27.1 the costs and time involved in switching production;

3.27.2 information on the production processes involved and the extent to which potential suppliers have spare production capacity; and

3.27.3 the degree to which any suppliers have switched production in the past, in particular in response to price changes.

68. Buyers must have a different willingness to pay for the product for price discrimination to be feasible.

69. We call this the possibility of arbitrage.

Defining the geographic dimension of a market

3.28 For the geographic market dimension we assess whether supply from different locations are sufficiently close substitutes to be in the same market.

3.29 The location of both suppliers and customers is relevant in determining the geographic dimension of a market. As indicated earlier, the market should capture the factors that shape and constrain rivalry between sellers.

3.30 However, the extent to which the location of suppliers and customers matters will depend on the nature of the market. For example, where customers have to travel to a supplier's location to purchase a product, we may define a market based on supplier location to best isolate the key competition issues.[70] Conversely, in cases where suppliers can feasibly price discriminate because customers have different supply alternatives, for example, we may define markets based on the location of customers. This approach is often taken when product is delivered directly to customers.[71]

3.31 When we consider the geographic market dimension based on supplier location, we use the hypothetical monopolist test to assess the region in which a hypothetical sole supplier would profitably impose a SSNIP from at least one location.

3.32 We ask whether customers would switch sufficient purchases from the hypothetical sole supplier in a region to suppliers located outside the region to make the SSNIP unprofitable.[72] Evidence we consider includes:

- 3.32.1 whether customers have previously switched purchases between different geographic locations in response to relative changes in prices;
- 3.32.2 the cost and difficulty of transporting the product, or the cost and difficulty for a customer to travel to a supplier's location, in relation to the price of the product; and
- 3.32.3 the views of buyers and suppliers regarding the likelihood of switching between different geographic sources of supply.

3.33 Where price discrimination is possible, our starting point for assessing the relevant geographic market dimension is the location of customers. Suppliers are competitors in the market if they sell to customers within the relevant region, even where they are located outside the region. This includes overseas suppliers if they supply in New Zealand.[73]

70. For example, customers (usually) travel to supermarkets to shop. In previous decisions involving the mergers of supermarkets, we defined geographic market dimensions as a radius of 5 km around the supermarkets in question. We accepted that some consumers may be willing to travel further, and took this into account in our analysis. See Foodstuffs (Auckland) Ltd, Foodstuffs (Wellington) Co-operative Society Ltd, Foodstuffs South Island Ltd and (separately) Woolworths Ltd and The Warehouse Group Ltd (Commerce Commission Decisions 606 & 607, 8 June 2007).

71. For example, fruit growers in Hawke's Bay typically sell their fruit to processors located in Palmerston North or Gisborne, benefiting from competition across these two sets of processors. For these growers, the relevant market includes both Palmerston North and Gisborne. However, for fruit growers located in or near Gisborne, the additional transportation cost of transporting fruit to Palmerston North makes transporting fruit to such processors uneconomic. If processors can price discriminate between growers from different regions, then the relevant geographic dimension of the market for Gisborne growers is Gisborne.

72. The terms of sale for all products sold outside of the region are held constant.

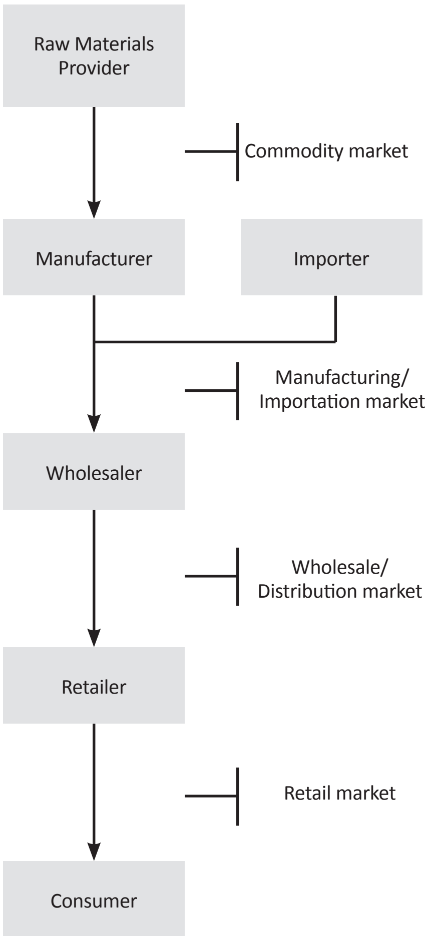
73. Where a firm not based in New Zealand does not currently supply into New Zealand, we consider that firm as a potential entrant rather than as a market participant even if they could supply New Zealand easily and quickly and without significant cost.

3.34 When we define the geographic market on the basis of the location of customers we consider the region from which a hypothetical sole supplier of the relevant product(s) could profitably impose a SSNIP on some buyers in that region.[74]

Defining the supply chain dimension of a market

3.35 A product typically passes through a series of levels of the supply chain. An example is given in Figure 1.

Figure 1: Different supply chain levels



3.36 A merger may affect one level of the supply chain (for example, wholesale) differently to others (for example, retail).

3.37 To account for this, we generally identify separate relevant markets at each level of the supply chain affected by a merger. This allows us to assess the potentially different impact of the merger on each. The hypothetical monopolist test may be less useful in defining the supply chain dimension than other dimensions of the market, so we tend to rely on evidence of market structure and supplier-customer relationships in the market.

74. The terms of sale for all products sold to buyers outside of this region are held constant.

3.38 We may, however, consider more than one level of the supply chain to be within the same market if:[75]

3.38.1 demand from one relevant level of the supply chain affects the demand at another level, such that a sole supplier at one level could not profitably impose a SSNIP due to substitution at another functional level – for example, this may be relevant if competition at the retail level between retailers constrains the prices that a wholesaler could profitably charge; or

3.38.2 in the event of a price increase, firms would easily, profitably and quickly (generally within one year) move from one level of the supply chain into another without significant cost (vertically integrate) – for example, a retailer moving into wholesaling in response to an increase in wholesale prices.

3.39 In assessing the appropriate supply chain dimension of markets, we can consider evidence that includes:

3.39.1 evidence of substitution between different levels of the supply chain; and

3.39.2 the scope for non-integrated firms to compete.

Defining the customer dimension of a market

3.40 Where relevant, we also examine the ability of suppliers to discriminate between customers because their competitive alternatives vary. For example, the requirements of larger customers can differ substantially from smaller customers, so that fewer suppliers can fulfil their demand.

3.41 Where suppliers price discriminate between customers, we consider whether to define markets based on particular uses of the product or the requirements of particular groups of customers.[76]

Defining the time dimension of a market

3.42 We do not usually define a time dimension for a relevant market, although we may do so if suppliers can price discriminate across time periods because buyers' competitive alternatives vary over time.

3.43 For example, if the products involved are perishable, and suppliers cannot easily switch production from one time period to another, a sole supplier in one period may profitably be able to increase prices by a SSNIP. This may also occur in markets in which depletable resources are involved, such as in forestry and gas production markets.[77]

75. See *Commerce Commission v Air New Zealand* above n 59 at [148]-[159].

76. For example, in Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 22 October 2008), we considered that the merging chicken processors had three groups of customers with different needs. Supermarkets required bulk shipments, fast food chains had very precise specifications, and food service customers were very fragmented. As a result, the competitive alternatives for customers varied between groups, so that suppliers could price discriminate. On that basis we defined separate markets for each customer group.

77. For example, see Shell Exploration Company BV and Fletcher Challenge Energy (Commerce Commission Decision 408, 12 October 2000) at [50]-[54].

Defining markets involving multi-sided platforms

3.44 It can be more difficult to define a market when a merger involves a 'multi-sided platform'. A multi-sided platform is one that creates value by facilitating interactions between two or more distinct groups of customers. For example, a newspaper acts as a platform for both advertisers and readers. The newspaper creates content. The content is used to attract readers, and readers are used to attract advertisers.

3.45 Where there is a multi-sided platform, distinct customer groups may represent a side of the platform. We consider whether to define a market for each side of the platform or a market for the platform itself.

3.46 As the platform's value to the customers on one side may vary depending on the number of customers on another side,[78] a firm running the platform will typically take into account the effect of its pricing decisions on each side of the platform. This can complicate applying the hypothetical monopolist test, as the relevant question becomes whether a hypothetical monopolist would find it profitable to increase prices by a SSNIP to one customer group, given the impact on purchases from these customers and other customer groups.

3.47 In these cases, we may incorporate the interdependencies in demand between different groups of customers when defining the relevant market on each side of the platform.[79]

78. It will also be relevant how valuable customers on one side of the platform are to the customers on the other side.

79. See, for example, Fairfax New Zealand Limited and Times Media Group Limited (Commerce Commission Decision 561, 14 October 2005) at [55] and [56].

Market share and concentration measures

3.48 Market share and concentration measures, and changes in market share or concentration resulting from a merger, can indicate the extent to which firms in a market are subject to competitive constraints, and the extent to which those constraints might change as a result of a merger. This is particularly the case for products that consumers regard as substantially the same (homogeneous products).

3.49 However, in all cases, market share measures are insufficient in themselves to establish whether a merger is likely to have the effect of substantially lessening competition. Whether or not a merger is likely to substantially lessen competition depends on a full analysis of the range of factors outlined in these guidelines.

Market share and concentration indicators

3.50 We use market share and concentration indicators to identify mergers which are less likely to raise competition concerns. These indicators are intended to provide an initial guide to merging firms, but are not a substitute for a full competition analysis.

3.51 A merger is unlikely to require a clearance application (or warrant an investigation if no clearance is sought) where, post-merger:

3.51.1 the three largest firms in the market have a combined market share of less than 70%, and the merged firm's combined market share is less than 40%; and/or

3.51.2 where the three largest firms in the market have a combined market share of 70% or more, and the merged firm's combined market share is less than 20%.

3.52 A hypothetical example illustrating how these indicators apply is provided in Attachment D.

3.53 The mere fact that a merger exceeds one of these indicators would not mean it would be likely to substantially lessen competition. Whether a merger is likely to substantially lessen competition depends on a full analysis of the range of factors outlined in these guidelines.

3.54 Equally a merger whose market share does not exceed one of these indicators may still be likely to substantially lessen competition. This may be the case if the market shares understate the competitive importance of the merging firms; for example, if one of the merging firms is a new competitor that is likely to expand without the merger, or where the market is typified by innovation.

3.55 As these indicators are based on market shares, if there is uncertainty about the appropriate market definition, the market definition that results in the worse case market share aggregation when applying the indicators should be adopted.

How we measure market shares

3.56 Market share can be measured in a number of ways. We choose the measure that we consider best reflects the competitive issue we are considering, taking into account the nature of the product and availability of data. Our starting point, assuming the relevant data is available, is to use:

3.56.1 revenue shares for differentiated products, as revenue share is likely to be a better indicator of market size and rival firms' competitive positions;

3.56.2 production and sales capacity[80] shares for firms with excess capacity supplying homogeneous products; and

3.56.3 shares of reserves for natural resources markets where reserves are easily accessible.[81]

3.57 We may also use a variety of these measures to highlight different aspects of competition in the market. We also often use the quantity sold in combination with other measures.

3.58 Where a firm does not currently supply the market, but is a near competitor, we include only the output or capacity that that firm could supply easily, profitably and quickly and without significant cost.

3.59 We include imports in our market share assessments. Imports channelled through a New Zealand firm are generally added to that firm's domestic production in assessing market share, rather than being treated as an independent source of supply.

3.60 Finally, we may use data from a number of years to calculate market share to ensure that the market shares are as representative of firms' market positions as possible. Market shares that are stable over a period of years are more likely to be informative.

80. Production capacity refers to the ability of a firm to produce a product. Sales capacity refers to a firm's ability to sell the product through such infrastructure as distribution facilities.

81. We may, for example, also use shares of customer numbers.

How a merger between competing suppliers can substantially lessen competition

3.61 A merger between competing suppliers can have the likely effect of substantially lessening competition through unilateral effects or coordinated effects. These concepts are explained below.

Unilateral effects

3.62 Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses. Unilateral effects do not cover effects arising from coordination with competitors (see paragraphs 3.84-3.90 below).[82]

3.63 Unilateral effects may also arise when an existing firm merges with a potential or emerging competitor. In such a case, the merger may preserve the market power of the existing firm that would have otherwise been threatened by the potential or emerging competitor.[83]

3.64 When we assess whether a merger is likely to give rise to unilateral effects, we consider whether the profitability of any price increase is likely to be defeated by competitors repositioning their products in the market, or expanding their sales, and/or by new competitors entering the market.[84]

3.65 Unilateral effects can occur in a range of markets, including:

3.65.1 markets for homogeneous products;

3.65.2 markets with differentiated products; and

3.65.3 markets in which suppliers negotiate with customers over prices or where prices are determined through a bidding process.

Homogeneous product markets

3.66 In markets where products are relatively similar ('homogeneous'),[85] buyers are largely indifferent about the firm from which they make their purchases. Examples include natural resources, such as gas, crude oil or coal.

3.67 In such markets, firms generally affect price by varying the quantity of product they produce or make available to the market. For example, a firm that accounts for a large portion of crude oil sales may increase the price of crude oil by restricting its output.

82. Unilateral effects can arise in markets with few competitors, even where none of the competitors are significantly larger than the others. In such a market, while firms set prices independently, they do so taking their competitors' prices into account. As a result, a merger that removes a competitor may mean that the merged firm has the incentive and ability to profitability increase prices. While this is sufficient for a finding of a unilateral effect, in response to this price increase, its competitors may also have the incentive and ability to profitably increase prices.

83. For example, see *Commerce Commission v Woolworths Limited* (CA), see n 42 above.

84. Entry and expansion are discussed in greater detail at paragraphs 3.93-3.112 below.

85. The division between homogeneous and differentiated product is not a bright line. Nearly all products have characteristics that are different to other products of the same class. For example, for products that are otherwise homogeneous, suppliers may seek to differentiate their products on the basis of related services.

3.68 As decreasing output can have the effect of increasing prices, we assess whether the merged firm would find it profitable to decrease output. The merged firm may find it profitable to decrease its output if:

3.68.1 the merger involves the acquisition of a competitor that customers would otherwise have bought from in response to an output decrease; and

3.68.2 any remaining competitors do not have sufficient capacity (or ability to expand capacity) to replace the output the merged firm removes.

3.69 In addition, the merged firm is more likely to find it profitable to decrease output if:

3.69.1 it has a large share of the market;

3.69.2 its customers are relatively insensitive to price increases;[86] and

3.69.3 it would not forego much profit by selling less volume.

3.70 A key consideration is whether the merged firm's competitors have the ability to swiftly and cost-effectively expand their output. This includes the extent to which competitors' capacity is committed to other customers under long-term contracts.

Differentiated product markets

3.71 Where products are differentiated, such as with branded products, some products will be closer substitutes and compete more vigorously with each other than other products. In those circumstances, unilateral effects are more likely to arise when the products the merging firms supply are relatively close substitutes.

3.72 This is because, by increasing prices, a firm faces a trade-off between higher profits on the sales it continues to make, and the profits it loses on the sales it no longer makes as customers purchase substitutes (or decide not to purchase at all). A merger between competitors can change this trade-off, as explained in the example below.

3.72.1 Pre-merger, if firm A increased its prices, it would lose some sales as customers switch to its competitors, including firm B. How many sales firm A would lose to firm B as opposed to other competitors depends on how closely substitutable the products they each supply are compared to the other alternatives. The more closely substitutable those products are, the more sales firm A would lose to firm B.

3.72.2 If firms A and B merge, then the sales that firm A would have lost to firm B pre-merger if it had increased prices may now be retained by the merged firm. The effect of this is to reduce the cost of increasing prices (ie, the lost sales). This increases the merged firm's incentive to increase prices. The larger the volume of sales diverted between firms A and B – ie, the more closely substitutable they are – the greater the incentive will be to increase prices. Similarly, the larger the profit margins on these diverted sales, the greater the incentive to increase prices.

86. That is, customers will not buy significantly fewer products when prices increase. This means that the merged firm may be able to increase prices significantly with a limited decrease in its volume of sales.

3.73 So when considering differentiated product mergers we assess how substitutable the merging firms' products are for each other.[87] [88]

3.74 Other considerations include:

3.74.1 customers' sensitivity to price increases; and

3.74.2 for each of the firms that is merging if one firm were to increase price without the merger:

3.74.2.1 the profit that firm would forego as a result of losing sales to the other merging firm; and

3.74.2.2 the profit that firm would forego as a result of losing sales to firms not involved in the merger.

3.75 The merged firm's incentive to increase prices also depends on competitor and customer responses, including the ability of competitors to reposition products or extend product lines so that competitors' products more closely compete with the merged firm's products.

Bargaining and bidding markets

3.76 In some markets, prices are set through bidding (such as by tender or auction) or by negotiation.

3.77 The price a customer pays depends, in part, on which suppliers the customer sees as its alternatives, those bidders who are willing to bid or supply, and the customer's ability to play these alternative suppliers off each other.

3.78 It follows that a merger between two competing suppliers reduces the supply alternatives a customer can play off against each other to obtain price concessions through negotiation (or bidding). This can enhance the merged firm's ability to profitably increase prices.

3.79 The extent to which this loss of competition is likely to affect post-merger prices depends, in part, on how closely the merging firms' products compete with each other relative to the products of other suppliers. A key consideration in our assessment is customers' negotiation and bidding processes, including the number and identity of suppliers that customers seriously consider for supply, and the relative ranking of such suppliers. For example, a merger between two firms that customers rate very differently may be less likely to give rise to competitive concerns than a merger between two firms that customers rank similarly.

87. A measure of this is the diversion ratio. The diversion ratio between firm A's product and firm B's product is equal to the fraction of sales lost by firm A to firm B when firm A raises the price of its product. Similarly, the diversion ratio between firm B's product and firm A's product is equal to the fraction of sales lost by firm B to firm A when firm B raises the price of its product. The diversion ratio between the products of firms A and B does not need to be symmetric.

88. Other factors that may be relevant to this assessment include product features and functions, customer preferences, and product availability and the locations in which products are available.

Pre-existing ownership that affects firms' incentives

3.80 Pre-existing ownerships between competitors can reduce relevant firms' incentives to compete.[89] This is illustrated in the example below.

3.81 Where an acquirer, firm A, already partially owns a competitor, firm B, this may make it profitable for firm A to increase prices higher than it would do if it did not own an interest in firm B. This is because when firm A is contemplating increasing its prices, it will take into account that while it will lose some sales to firm B, it will regain a portion of the profits it loses from those sales through its rights to firm B's profits. This additional benefit may be sufficient to provide an incentive for firm A to increases prices.

3.82 Where pre-existing ownership is present, we consider:

3.82.1 whether the ownership is likely to continue in the future scenarios with and without the merger;[90]

3.82.2 the effect of the ownership on incentives for the firms involved to compete in these scenarios.

3.83 We take the firm's incentive to compete into account when assessing the level of competition in the scenarios with and without the merger and whether any loss of competition resulting from the merger is substantial.

Coordinated effects

3.84 A merger can substantially lessen competition if it increases the potential for the merged firm and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market.[91] Unlike unilateral effects, in which a substantial lessening of competition can arise from the merged firm acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.

3.85 Coordinated behaviour involves firms recognising that they can reach a more profitable outcome if they accommodate each other's price increases. Firms may coordinate their behaviour on price or any other dimension of competition or by allocating customers or territories.

3.86 We assess whether:

3.86.1 a market is vulnerable to coordination;[92] and

3.86.2 a merger changes the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

89. This is in addition to our consideration of whether persons are interconnected or associated (see paragraphs 2.4 to 2.9 above).

90. If there are any likely changes to this ownership, we incorporate these into our assessment.

91. For example, Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 22 October 2008).

92. This includes any evidence of prior coordinated conduct in the market.

3.87 For example, if a merger removes a particularly aggressive or destabilising competitor, it may make coordinated behaviour more likely.

3.88 Successful coordination requires firms to reach at least an implicit agreement,[93] and then to maintain that agreement by detecting and punishing any firm that deviates from the agreement.

3.89 Market features that may facilitate coordinated conduct include:

3.89.1 homogeneous products;

3.89.2 a small number of competitors and an absence of a particularly vigorous competitor or strong competition from outside the coordinating firms;

3.89.3 firms repeatedly interacting through, for example, numerous transactions, through contact in other markets or other repeated interactions, for example, through industry organisations or meetings (eg, to set technical standards);

3.89.4 firms of similar size and cost structures;

3.89.5 little innovation, stable demand and lack of supply shocks/volatility;

3.89.6 firms that can readily observe each others' prices or volumes; and

3.89.7 firms interrelated through association or cross-partial ownership.

3.90 Not all these factors need to exist for a market to be vulnerable to coordinated behaviour.

93. This includes behaviour that may not be regarded as a contract, arrangement or understanding for the purpose of assessing whether a cartel prohibited by the Commerce Act exists.

Entry and expansion, countervailing power, and efficiencies

3.91 In assessing whether a merger (whether between competitors or otherwise) would be likely to have the effect of substantially lessening competition, we assess whether, if prices increase:

3.91.1 existing competitors would expand their sales, or new competitors would enter and effectively compete with the merged firm; and

3.91.2 buyers can exercise countervailing power (or, in the case of potential buyer market power concerns, suppliers).

3.92 We also consider:

3.92.1 whether the merger creates efficiencies that will be passed onto customers; and

3.92.2 the impact of a firm's ownership on its incentives.

Entry and expansion

3.93 Entry or expansion can occur in a number of ways, for example by establishing a new production plant, or through importing.

3.94 Large customers may also sponsor entry and expansion, a type of entry discussed under the assessment of countervailing power.

3.95 We assess whether entry by new competitors or expansion by existing competitors is likely to be sufficient in extent in a timely fashion to constrain the merged firm and prevent a substantial lessening of competition. This is referred to as the 'LET test'.[94]

3.96 The LET test is satisfied when entry or expansion in response to a price increase or other exercise of market power is Likely, and sufficient in Extent and Timely enough to constrain the merged firm.

3.97 The obstacles to entry and expansion that firms face (entry and expansion conditions) are relevant to the LET test.

Likelihood of entry or expansion

3.98 Entry or expansion must be likely before it could constrain the merged firm and prevent a substantial lessening of competition. The mere possibility of entry or expansion is insufficient.

3.99 While we look at evidence of whether firms are already planning to enter or expand (and consider the impact of that entry or expansion), what matters for our analysis is whether entry and expansion in addition to that already planned would be likely if prices increased post-merger.

94. See *Air New Zealand/Qantas v Commerce Commission*, see n 34 above, at [102], *Commerce Commission v New Zealand Bus Ltd* (HC), above n 20 at [146]-[160] and *New Zealand Bus Ltd v Commerce Commission* (CA), above n 28 at [252].

3.100 The likelihood of entry or expansion depends on whether firms can profitably enter or expand the market in light of any entry and expansion conditions. Relevant considerations include:

3.100.1 the revenue a firm expects to earn based on post-entry/expansion prices, costs and quantities;

3.100.2 the return the firm might otherwise earn using its resources elsewhere (opportunity costs); and

3.100.3 the relative risk of entry/expansion compared to other alternative investments.

3.101 Evidence of previous entry and expansion following price increases is relevant to our assessment of whether entry or expansion is likely.[95]

3.102 The type of market may also be relevant. For example, a mature market that exhibits flat or declining demand may mean profitable entry and expansion is more difficult. The firm would have to win its competitors' existing customers, rather than being able to target new customers coming into the market.

Extent of entry or expansion

3.103 Entry or expansion must also be of a sufficient extent to constrain the merged firm and prevent a substantial lessening of competition. Small scale entry is unlikely to pose a sufficient competitive constraint on the merged firm. However, entry or expansion may be of sufficient extent even if that entrant or existing competitor remains smaller than either of the merging firms pre-merger.

3.104 Where products are differentiated, whether entry or expansion is sufficient in extent also depends on whether the products supplied by the entrant or existing competitor are a sufficiently close substitute to the product(s) supplied by the merged firm.

Timeliness of entry or expansion

3.105 Finally, entry or expansion must also be likely to occur within a reasonably short time period following a price increase or other exercise of market power in order for it to constrain the merged firm and prevent a substantial lessening of competition.

3.106 The appropriate timeframe may vary from market to market according to the particular characteristics of the market concerned.[96] For example, in some markets where products are supplied and purchased on a long-term contractual basis, customers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

95. Similarly, in relation to the potential for entry or expansion by imports, evidence of whether importers have previously started to supply or increased supply in response to a price increase is relevant to our assessment of whether import entry or expansion is likely.

96. In general, we consider entry and expansion within two years is sufficiently timely. However, this timeframe may vary depending on the facts of the case. For example, in *Commerce Commission v New Zealand Bus Ltd*, see n 20 above, at [155] the court adopted a three year timeframe.

Conditions of entry and expansion

3.107 The expected profitability of entry and expansion depends on the costs and risks associated with entry and expansion. Such conditions can reduce the likelihood, extent and/or timeliness of entry and expansion, and are relevant to the LET test.[97]

3.108 Conditions of entry and expansion can take a variety of forms, including structural, regulatory and strategic conditions.

3.109 Structural conditions are associated with the technologies, resources or inputs a firm would need to enter or expand. These include:

3.109.1 economies of scale, which refers to per unit costs falling as production increases;[98]

3.109.2 economies of scope, which refer to when per unit costs fall when more than one product is produced (or transported etc);[99]

3.109.3 switching costs, which are costs a customer incurs when switching to use a new supplier;[100]

3.109.4 network effects, which refer to when a product or service becomes more valuable the more users it attracts (for example, a new entrant in the social media sector may be at a disadvantage to a competitor that already has a well-established customer base);

3.109.5 sunk costs; and

3.109.6 the difficulties a firm would face in accessing required inputs or product distribution channels.

3.110 Regulatory conditions include:

3.110.1 resource management or other planning consent requirements;

3.110.2 licensing requirements for a business or product;

3.110.3 regulations governing standards and quality; and

3.110.4 intellectual property rights, which may mean that, for example, entry is not possible while a product is patent protected.

97. While the proposition that a firm's market power depends substantially on the level of barriers to entry and expansion in the relevant market is well established in New Zealand competition law (see *Southern Cross Medical Care Society v Commerce Commission* (2001) 10 TCLR 25), New Zealand's courts have subsequently highlighted that the question of whether conditions in a market qualify as a barrier to entry, however defined, is less important than whether those conditions have the potential to prevent, impede or slow entry and expansion. See *Air New Zealand/Qantas v Commerce Commission*, see n 34 above, at [102], endorsed in *New Zealand Bus Ltd v Commerce Commission* (CA), see n 28 above, at [252].

98. If production is characterised by economies of scale, an entrant may be at a competitive disadvantage since it will be unlikely to have a sufficient share of the market to have low enough costs to compete effectively. Alternatively, economies of scale may prevent profitable entry if in the process of achieving efficient scale an entrant would drive prices down so that the entrant's expected returns do not justify entry.

99. Economies of scope may require an entrant to produce a minimum range of products in order to be an effective competitive constraint on the merged firm.

100. If switching costs exist, a new entrant might find it difficult or costly to induce customers to switch suppliers. Switching costs could include charges customers must pay to terminate a supply contract and costs arising from product compatibility issues.

3.111 Strategic conditions arise where incumbent firms take action to discourage prospective entrants or expansion, such as by:

3.111.1 raising customers' switching costs (for example, by establishing long-term contracts or establishing strong customer loyalty through points programmes); and

3.111.2 signalling through present or past conduct that entry would provoke an aggressive response.

3.112 When considering entry and/or expansion through imports, we also consider further specific factors such as:

3.112.1 access to the New Zealand market (including tariffs, quotas, import licences/duties, anti-dumping regulations and other laws);

3.112.2 customer preference for a New Zealand supplier (reasons for this could include, among others, that customers need to buy other associated services from a New Zealand supplier, or because customers need a supplier to be able to supply on a 'just-in-time' basis);

3.112.3 the costs of, and obstacles to, transporting the product in relation to the price of the product, which would depend on factors including:

3.112.3.1 the logistics of shipping the product and the establishment of distribution networks;

3.112.3.2 any need for minimum shipping quantities to ensure economic supply; and

3.112.3.3 the perishability of the relevant products.

Countervailing power

3.113 A merged firm's ability to increase prices profitably may be constrained by the ability of certain customers to exert substantial influence on negotiations.[101]

3.114 Countervailing power is more than a customer's ability to switch from buying products from the merged firm to buying products from a competitor.[102] Similarly, a customer's size and commercial importance is not sufficient in itself to amount to countervailing power.

101. For an example of our assessment of countervailing power in practice, see Fonterra Co-operative Group Ltd and New Zealand Dairy Foods Ltd (Commerce Commission Decision 562, 9 November 2005).

102. We consider this as part of our analysis of existing competition and potential entry and expansion.

3.115 Instead, countervailing power exists when a customer possesses special characteristics that give that customer the ability to substantially influence the price the merged firm charges. This may be the case if:

3.115.1 the customer can discipline the merged firm by switching or credibly threatening to switch to suppliers of the same product in other geographic markets where competitive conditions are different;

3.115.2 the customer can switch or credibly threaten to switch to suppliers of other products it acquires from the merged firm;

3.115.3 the customer can take action to reduce the merged firm's sales by, for example, giving less favourable retail placement to the merged firm's products;

3.115.4 the customer purchases enough product to make it feasible for the customer to sponsor new entry; or

3.115.5 the customer is able to self-supply by, for example, importing or by vertically integrating.

3.116 However, in all of these cases the countervailing power must be sufficient to constrain the merged firm. While customers may have a degree of countervailing power, a merger that removes a supplier that was an important alternative for that customer will usually reduce that customer's negotiating power. In that case, the customer's remaining countervailing power may be insufficient to constrain the merged firm effectively.

3.117 Additionally, where a merged firm can price discriminate, the fact that one or more customers have sufficient countervailing power to protect their own position may not be sufficient to constrain the merged firm's ability to increase prices across the remainder of the market. A substantial lessening of competition may arise in that circumstance.

Efficiencies

3.118 While efficiencies tend to be most relevant in the context of an authorisation, efficiencies may be relevant to our assessment of whether a merger would be likely to substantially lessen competition in a market.[103]

3.119 However, efficiency gains are rarely of the required type, magnitude and credibility. The applicant must satisfy us that efficiencies would be realised in a timely fashion,[104] that they would not likely be realised without the merger, and that they would be passed on to buyers sufficiently to prevent a finding of a substantial lessening of competition.

103. *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* (CA), above n 32 at [249] per Glazebrook J.

104. The timeframe for analysing efficiencies will be informed by the timeframe for the competition analysis. Efficiencies must be sufficiently realised and passed onto consumers within the timeframe for the competition analysis so that a substantial lessening of competition is not likely. The efficiencies must also be unlikely to be realised without the merger, as set out above.

3.120 Efficiencies are relevant when efficiency gains prevent customers from being adversely affected in a material way (such as by preventing consumers from paying substantially higher prices, or receiving otherwise substantially inferior products), so that the merger would not be likely to substantially lessen competition.

3.121 For the reasons explained below, the types of efficiencies we look for are variable cost savings or product enhancements that increase product demand.[105]

3.122 Variable cost savings are relevant because if everything else is equal, the lower a firm's marginal costs – which largely depend on variable cost – the lower the firm's profit-maximising price. Even a monopoly that experiences a decrease in its marginal costs will have an incentive to lower its price.

3.123 As a consequence, if a merger reduces a firm's marginal cost, customers may not be materially adversely affected by the merger.

3.124 Product enhancements can include things such as product quality improvements, additional product features, and increased network efficiencies. Even when the merger results in prices being higher than they would have been, the benefit to customers (as measured by their willingness to pay) from these product enhancements may outweigh the higher prices arising from the merger such that demand overall increases compared to the situation without the merger.

3.125 If a merger results in sufficient improvements in the non-price elements of the merging firm's products, that may prevent customers from being adversely affected in a material way, taking into account the price and non-price effects.

The impact of firms' ownership on their incentives

3.126 We also take into account the impact of firms' ownership on their incentives to compete. For example, suppliers that are co-operatively owned by their customers may have less incentive to increase prices to their customers (as those customers are also the firm's owners) than those suppliers owned by investors.

105. In the case of vertical mergers, there may also be an improvement in allocative efficiency if the merger results in the removal of pre-merger double marginalisation.

Chapter 4. How we assess mergers between competing buyers

4.1 Similar to a merger between competing suppliers, a merger between competing buyers may lessen competition increasing the merged firm's ability, unilaterally or in coordination with other firms, to exercise market power when buying products.[106] [107]

4.2 Buyer market power is, in many ways, the mirror image of market power on the selling side.[108] In particular, it is the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time such that the amount of input sold is reduced. That is, the price of the product is depressed so low that (some) suppliers no longer cover their supply costs and so withdraw supply (or related services) from the market.[109] Such an outcome reduces the amount of product being supplied damaging the economy.

4.3 As both supplier and buyer market power involves decreases in the amount of product sold, our assessment of buyer market power is similar to the assessment of supplier market power.

4.4 In particular, we use a variation of the hypothetical monopolist test to define the relevant market (see paragraphs 3.17-3.24 above). We are interested in the ability of suppliers, in response to a decrease in the price of their product, to switch to alternative buyers in sufficient quantities to render a hypothetical monopoly buyer's (a monopsonist's) price decrease unprofitable. We refer to a market defined in this way as a 'buying-side market'.

4.5 Suppliers may also reposition or modify their products so there are alternative buyers for their products. If they can find alternative buyers in sufficient quantities, this will make the hypothetical monopsonist's price decrease unprofitable. We consider this as part of the market definition exercise where such repositioning or modification can be carried out easily, profitably and quickly (generally within one year) and without significant cost.

4.6 The relevant market is in general the smallest group of products and the smallest geographic area in which a hypothetical monopsonist would decrease prices by a SSNIP.

106. For example, see Fonterra Limited and New Zealand Dairies Limited (in receivership) [2012] NZCC 21 and Fonterra Co-operative Group Limited [2012] NZCC 7. The latter determination relates to an application for authorisation of an agreement.

107. As in the rest of these guidelines we use the term 'price' as shorthand for all dimensions of competition, including quality, range, level of innovation, service or any other element of competition valued by buyers. For an explanation of what competition means in this context, see paragraph 2.18 above.

108. On the selling side we are also concerned with price changes that result in decreases in output. This entails price increases that cause buyers to buy less of the product.

109. A price decrease following a merger between buyers is not always evidence of buyer market power. Rather it could be the outcome of countervailing power and/or reduced costs of supply (including reduced transactions costs). For example, the merged firm may obtain a cost-based volume discount post-merger. In the case of countervailing power, prices will decline but not so much as to fall below competitive levels. In such situations, buyers constrain the ability of a supplier (or suppliers) to exercise market power on the selling side.

4.7 We assess market shares based on shares of products purchased, not produced or sold. We apply the same market share and concentration indicators for mergers between competing buyers as we do for mergers between competing sellers (see paragraphs 3.50-3.55 above).[110]

4.8 Other factors we consider when assessing a merger of competing buyers include whether:

4.8.1 a new buyer would enter or an existing buyer would increase its purchases if prices decreased (see paragraphs 3.93-3.112 above);

4.8.2 any suppliers have market power;[111]

4.8.3 it seems likely that suppliers will exit the market or otherwise reduce production, or will reduce investments in new products and processes, in response to any price decrease;

4.8.4 buyers of the relevant product(s) have an incentive to restrict the quantity of inputs that they purchase, taking into account the impact on their profits in downstream markets and their ownership (see paragraph 3.126 above);[112] and

4.8.5 by reducing the amount it purchases, the merged firm may find it more difficult to access adequate supply of the relevant product in the long run.

110. Buying-side markets are often characterised by geographic price discrimination; that is, buyers pay suppliers located in different areas different prices for their products. In such cases, we usually define different relevant markets by supplier's location (or the location of groups of suppliers), and calculate market shares for each relevant market. For example, suppliers A through D may be in one market and the merging firms buy 40% of those suppliers' sales, while suppliers E through K are in another market and the merging firms buy 60% of those suppliers' sales.

111. If the price of the relevant product(s) is above competitive levels before the merger, any exercise of buying power is more likely to be an exercise of countervailing power.

112. In particular, buyers that are co-operatively owned by their suppliers may have less incentive to decrease prices to those suppliers.

Chapter 5. How we assess mergers where the parties are not direct competitors

5.1 A merger between suppliers (or buyers) who are not competitors but who operate in related markets is less likely to result in a substantial lessening of competition than a merger between competitors. This is because such mergers do not lead to a direct loss of competition between the merging firms.

5.2 Nevertheless, such a merger can result in a substantial lessening of competition. This can occur where the merger gives the merged firm a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively, or where the merger increases the likelihood of coordinated behaviour between firms.

Vertical mergers

5.3 A vertical merger is a merger between firms operating at different levels of a product's supply chain (for example, a manufacturer and a wholesaler, or a wholesaler and a retailer).[113]

5.4 A vertical merger may substantially lessen competition where the merger increases the merged firm's ability and/or incentive to prevent or hinder competition by:

5.4.1 refusing to deal with competitors completely (total foreclosure); or

5.4.2 raising prices it charges these competitors (partial foreclosure).

113. For an example, see Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33, where in some situations Vodafone and TelstraClear had a vertical supply relationship. Also see Cavalier Wool Holdings Limited and New Zealand Wool Services International Limited (Commerce Commission Decision 725, 9 June 2011) where in the context of an application for authorisation of a merger, we considered whether Cavalier Wool would be able to leverage its market power in relation to wool scouring services into downstream markets, especially those for the manufacturing of carpets, given that Cavalier Wool was vertically integrated with Cavalier Bremworth.

5.5 Foreclosure can either be:

5.5.1 input foreclosure – where the merged firm refuses to supply an input to a downstream competitor[114] or raises the price of the input;[115] or

5.5.2 customer foreclosure – where the merged firm disadvantages an upstream competitor in the sale of that competitor's products by limiting access to customers.[116][117]

5.6 We consider whether the merged firm would have the ability and/or the incentive to foreclose its competitors, and the likely effect of that foreclosure on competition.

Ability to foreclose

5.7 A firm is generally only able to foreclose competitors if it has market power at one or more level(s) of the supply chain. If a firm does not have market power, its competitors could switch to other suppliers or purchasers. This would mean that the firm is unlikely to have the ability to foreclose its competitors.

Incentive to foreclose

5.8 A firm will only rationally foreclose competitors if it is profitable to do so.[118] For example, for input foreclosure, a firm must weigh up an increase in profits in a downstream market against a decrease in profits in the upstream market where the foreclosure occurs. This is because:

5.8.1 the firm's profits in the input market falls as the number of units sold fall;[119] but

5.8.2 the firm's profits in the downstream market may increase if it can win a proportion of the sales its competitors lose as a result of the foreclosure.

Effect on competition

5.9 The ultimate question is whether the competition lost from potentially foreclosed competitors is sufficient to have the likely effect of substantially lessening competition in light of the remaining competitive constraints.[120]

5.10 A substantial lessening of competition may arise where foreclosure makes entry and expansion more difficult, or otherwise reduces a competitor's (or competitors') ability to provide a competitive constraint. Foreclosure does not need to force a competitor, or competitors, to exit the market to have this effect.

114. A downstream competitor is a competitor active at a level of the supply chain closer to consumers. So a retailer is downstream compared to a wholesaler.

115. For example, in Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33, Vodafone was purchasing the backhaul transmission network of TelstraClear. Backhaul is a key input in the provision of a mobile phone service. We considered whether or not Vodafone would have the ability and incentive to foreclose its mobile competitors by refusing access to backhaul transmission or raising access prices with the effect of substantially lessening competition.

116. For example, if a manufacturer entered into exclusive agreements with retailers representing a significant volume of sales this could disadvantage competing manufacturers.

117. This can include a firm refusing to purchase inputs from a competitor.

118. When assessing a merger between cooperatives, we will take into account whether the firm's or firms' ownership (as appropriate) reduces the incentive to foreclose competitors (see paragraph 3.126 above).

119. If the market is not characterised by price discrimination, lost profits from decreased input sales may be mitigated by increased revenues on the units of input the merged firm continues to sell.

120. Entry and expansion, countervailing power and efficiencies are also relevant to vertical mergers.

Conglomerate mergers

5.11 A conglomerate merger is a merger between firms that supply products that may relate to each other, for example, complementary products.

5.12 Like vertical mergers, a conglomerate merger may increase a merged firm's ability and/or incentive to foreclose competitors.

5.13 Foreclosure arises differently in a conglomerate merger than in a vertical merger. For example, a merged firm may provide bundled discounts where customers buy products together rather than separately, or may refuse to sell one product to customers unless they also buy a second product from it (tying).[121]

5.14 Such bundled discounts or tying may mean that competitors that cannot sell the same range of products as the merged firm may be foreclosed. This means they would not provide a competitive constraint on the merged firm for the product both firms sell. This could occur where, for example, as a consequence of bundled selling, a competitor is denied access to sufficient market demand to achieve competitive scale.

5.15 As with vertical mergers, we consider whether there is likely to be foreclosure and whether that foreclosure is likely to have the effect of substantially lessening competition in a market in light of the remaining competitive constraints.[122]

121. For example, in Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33, Vodafone (owner of a large mobile network) was acquiring TelstraClear's fixed line telephone network. We considered whether the merger would give Vodafone the ability and incentive to hinder competitors offering a mobile service by offering fixed line and mobile services together as a bundle with the effect of substantially lessening competition in mobile services markets.

122. Also as with vertical mergers, entry and expansion, countervailing power and efficiencies are also relevant to conglomerate mergers.

Chapter 6. The Commission's merger clearance process

6.1 In this section we describe the process we follow when considering merger clearance applications. We also describe our approach to confidential information.

6.2 We recognise that mergers are often time-sensitive, so we have designed our process to ensure we can complete clearance investigations as quickly and transparently as possible, while adhering to the principles of natural justice.

6.3 Our process has the following stages: pre-clearance, the clearance application, our investigation and determination, and post-determination.

Pre-clearance – pre-notification discussions

6.4 A person may apply to us for clearance if they propose to acquire assets of a business or shares.

6.5 We encourage potential applicants to inform us (by contacting the Competition Manager)[123] about potential clearance applications as early as possible.

6.6 We also encourage applicants to have pre-notification discussions with us before submitting a clearance application. We will have pre-notification discussions where we are satisfied that an applicant has a good faith intention to proceed with a merger.[124]

6.7 We treat the fact and content (including any documents provided) of all pre-notification discussions as confidential until an application is registered. We do not seek third party views at the pre-notification stage.

6.8 While pre-notification discussions are not compulsory, they are designed to reduce the time we need to investigate once we have received a clearance application. Pre-notification discussions can benefit both the applicant and the Commission by:

6.8.1 educating our investigation team about markets that are complex and/or unfamiliar;

6.8.2 setting the scene for the transaction, including its rationale, at an early stage;

6.8.3 clarifying what information and evidence we are likely to need, and identifying useful evidence that may assist our analysis (including economic evidence);

6.8.4 providing us with an opportunity to indicate further information (including competition issues) that should be included in the application; and

6.8.5 allowing the applicant and us to have a preliminary discussion about likely competition issues (although our comments are only indicative and not binding).

123. The Competition Manager can be contacted at competition@comcom.govt.nz

124. As evidenced by, for example, adequate financing, heads of agreements, or evidence of board-level consideration. We will also take into account other evidence of good faith intention; for example, when an acquirer is genuinely considering making a bid at auction.

6.9 These pre-notification discussions allow us to plan more effectively for a clearance process, and to allocate appropriate resources. This means we can provide the applicant with a better indication of the likely timeframe for our investigation.

6.10 To get the most out of these discussions, we encourage at least one of the applicant's senior employees to attend. We also expect an applicant to provide us with a substantially developed draft clearance application at least two working days before meeting with us, to allow us to review the application prior to meeting.[125]

125. A longer timeframe may be appropriate for more complex mergers.

Applying for clearance

Requirements for a clearance application

6.11 Clearance applications must be made in the prescribed form, available on our website at www.comcom.govt.nz/clearances

6.12 The application form sets out the information we need to start our investigation, and allows applicants to present their arguments (and supporting evidence, including any expert economic evidence the applicant wishes to provide).

6.13 We require both a confidential version and a public version of the application. In the confidential version any information for which confidentiality is sought must be highlighted and contained in square brackets. In the public version the confidential information should be removed from within the square brackets, with the brackets remaining, ie, [ ].

6.14 The application must be accompanied by payment of the $2,300 filing fee (GST incl). Payment can be made by cheque or electronic payment into our bank account. Please use the applicant's company name as the reference when depositing funds electronically. Our bank account details are:

Commerce Commission
BNZ North End
02 0536 0329867 00

6.15 After receiving a clearance application and payment, we check that the application is in the correct form and completed to a sufficient standard to enable us to proceed with our investigation. We then register the application.

6.16 If the application does not meet our requirements, we inform the applicant as soon as we can and give them the opportunity to remedy this.

6.17 If the applicant does not address our concerns, or does not pay the fee, we may decline to register the application.[126]

Confidentiality as to the fact of a clearance application

6.18 Applicants sometimes ask that we do not publicly disclose the fact that they have made a clearance application (fact confidentiality).[127]

6.19 We consider requests for fact confidentiality on a case-by-case basis, but we are only likely to grant fact confidentiality for a limited period and only in exceptional circumstances. This is because fact confidentiality is likely to severely hamper our investigation, as investigators cannot gather information from market participants and test information provided in a clearance application.

126. Commerce Act 1986, s 66(2).

127. Applicants may request fact confidentiality because, for example, the merging firms have not informed their employees about the merger, or there is competition from other parties to acquire the business in question.

Publication of a public version of a clearance application

6.20 Once we have registered a clearance application and agreed with the applicant which information is confidential (our approach to confidentiality is discussed later in this section), we publish a public version (a version that omits the confidential information) on the clearance register on our website and issue a media release. We do this to inform the public of the proposed merger and to enable third parties to make submissions to us.

How we investigate and determine a clearance application

Who determines a clearance application

6.21 Each clearance application is decided by a Division of Members of the Commission appointed by the Chair for that purpose.

6.22 The Division is supported by a multi-disciplinary team of Commission staff, comprising one or more investigators, and economic and legal staff. Staff brief the Division during the investigation, and the Division provide staff with guidance and direction.

Indicative clearance timeline

6.23 The Commerce Act sets out a 10 day statutory timeframe in which we must clear or decline to clear a merger. If this period expires without a decision, we are deemed to have declined to give clearance. As it is seldom possible for us to process a clearance application within 10 working days, we invariably seek an extension beyond this timeframe. This is done once we have made an initial assessment of the issues raised by and complexity of a clearance application.[128]

6.24 We have committed to deciding clearance applications within an average of 40 working days of registering the application. We have developed an indicative investigation timeline to allow us to do this.

Day 1	Clearance application registered.
By day 10	We provide a draft investigation timeline. We seek an extension based on the draft timeline.
By day 15	We may publish a statement of preliminary issues on our website (discussed at paragraphs 6.50-6.51 below).
Day 25	We give clearance or send a letter of issues (discussed at paragraphs 6.52-6.54 below).
Day 30	We meet with the applicant and provide an updated tentative timeline.
Day 40	We give, or decline to give, clearance.

6.25 The exact time we take to reach a decision varies depending on the merger involved. More straightforward clearance applications may take less than 40 working days. More complex clearance applications may take longer and the process is likely to continue beyond 40 working days as shown below.

Day 40	We send a letter of unresolved issues (discussed at paragraph 6.55 below) and seek an extension.
Day 45	We meet with the applicant about the letter of unresolved issues and provide an updated tentative timeline.
Day 60+	We release our final decision.

128. We make extension requests verbally in the first instance, although we will follow that request with a written request by email or letter.

6.26 We try and give the most accurate timeline we can at an early stage. However, we may have to seek further extensions later in the process, particularly where we need to:

6.26.1 consider divestments that have been offered;

6.26.2 test new information provided by the applicant or market participants (including economic evidence); and/or

6.26.3 provide an applicant with the opportunity to fully respond to any unresolved issues.[129]

Communication with the applicant

6.27 A member of the investigation team contacts the applicant early in the investigation to let them know who will be the main point of contact.

6.28 Throughout our investigation we keep in regular contact with the applicant about progress. How often depends on the circumstances of the case.

Seeking views from market participants

6.29 We gather and analyse information from market participants, such as customers, existing and potential competitors, and suppliers, to help us assess the likely effects of the merger and to test the information provided in a clearance application.

6.30 We contact those we think are likely to have information that is relevant and useful to our investigation.

6.31 However, anyone who has information that they believe is important for our investigation, or wants to provide us with a written submission in response to the statement of preliminary issues, can contact us at registrar@comcom.govt.nz

How we gather information

6.32 We gather information from applicants, market participants and other parties in a variety of ways, depending on the circumstances. This can include through face-to-face interviews, telephone interviews, letters or emails.

6.33 We usually seek information on a voluntary basis, although in some cases we use our information-gathering powers to require parties to provide information. We discuss our powers to do so in more detail at paragraphs 6.43-6.48 below.

6.34 It is an offence for any person to attempt to deceive or knowingly mislead us through their communications with us, voluntary interviews, emails or telephone conversations.

The interview process

6.35 Where we wish to interview someone, we make contact to request a time for a face-to-face or telephone interview. Before the interview, we provide a public version of an application for clearance, explain our processes and provide an agenda or a list of topics to be discussed (including any specific information we require).

129. Our indicative timeframes do not include a conference. This is because it is rare for us to hold a conference for clearance applications. To date, we have found that gathering and testing information through information requests and interviews has enabled us to make well-informed decisions. However, we may hold a conference when we consider it appropriate. If we decide to hold a conference, this will extend the timeline due to the practicalities of organising and holding a conference. If a conference is held, parties who attend, as well as the merging firms, can appeal our determination of the application for clearance.

6.36 We prefer to conduct these interviews on a voluntary basis. However, under our powers to require information, we can require persons to appear before us to give evidence under oath.

6.37 We prefer to record interviews and can provide a copy to the interviewee on request. Recording interviews ensures that both parties have access to an accurate record of what was discussed, and allows us to converse freely without the need to take extensive notes.

6.38 Interviews often include discussion of information that is confidential. We explain our approach to confidentiality at paragraphs 6.66-6.71 below. However, interviewees are encouraged to identify all commercially sensitive and/or confidential information during the interview.

6.39 We often request that interviewees provide evidence or information to substantiate their arguments. This is more likely to happen where such arguments are key considerations in our assessment of a clearance application.

Information requests

6.40 We also often ask applicants, market participants or other parties to provide information relevant to our investigation, such as market shares and future strategies.

6.41 We recognise that in many cases such information is confidential. As with interviews, we encourage parties to identify all commercially sensitive and/or confidential information when providing information to us.

6.42 When we make an information request, we usually specify a deadline for the information to be provided. This allows us to progress our investigation as quickly as possible. We encourage parties to contact us as soon as possible if they believe they cannot meet the deadline.

Our statutory information-gathering powers

6.43 We can require a person to supply information or documents or give evidence by issuing a statutory notice (a section 98 notice).

6.44 There are a number of reasons why we may decide to use a section 98 notice, including that:

6.44.1 it ensures information is gathered in a timely manner;

6.44.2 parties may prefer it because, for example, they might be under a duty such as a confidentiality obligation not to reveal that information unless compelled to do so; or

6.44.3 parties with relevant information are unwilling to disclose the information.

6.45 A section 98 notice explains what is required under the notice (for example, information, documents and/or giving evidence in person), and provides a timeline for providing that information or documents, or to attend to give evidence.

6.46 A section 98 notice creates a legal obligation for the recipient to provide us with the information or documents requested. It is an offence to refuse or fail to comply with a section 98 notice without reasonable excuse.

6.47 If the recipient anticipates difficulty in complying with a section 98 notice, they should let us know as early as possible and explain the reasons why. For example, if the information we have asked for does not exist or the documents are no longer in the recipient's possession or control, the recipient must explain why the requested documents or information cannot be provided.

6.48 Similarly, if the recipient wishes to seek an extension to the deadline, they should make a request stating the reasons and allowing sufficient time for us to process the request before the original deadline.

Documents we prepare during the assessment of a clearance application

6.49 As indicated above, there are a range of documents we may prepare at different stages during our investigation. These include a statement of preliminary issues, a letter of issues, and a letter of unresolved issues.

Statement of preliminary issues

6.50 For most clearance applications, we publish a statement of preliminary issues.[130] This outlines our preliminary view of the competition issues (based on the information we have at that time) with the aim of:

6.50.1 increasing the transparency of our process;

6.50.2 providing interested parties with an opportunity to consider the issues we have identified; and

6.50.3 uncovering further information which might assist our investigation.

6.51 We publish a statement of preliminary issues on our website approximately 15 to 25 working days after registering the application. We also issue a media release inviting responses to be made to us.

Letter of issues and letter of unresolved issues

6.52 We send a letter of issues to an applicant where, following our initial investigations, we have concerns about potential competition issues that may arise from a proposed merger.

6.53 A letter of issues is not a final decision and does not mean that we intend to decline to clear a merger.

6.54 A letter of issues aims to clearly outline our concerns and invite the applicant to provide further information that might address these concerns. We often meet with applicants to discuss a letter of issues, although we prefer that applicants also provide a written submission (and supporting evidence) as part of their response.

6.55 If, following an applicant's response to the letter of issues, we consider some issues remain unresolved, we are likely to send a letter of unresolved issues to the applicant. A letter of unresolved issues provides the applicant with a further opportunity to provide additional information or submissions to allay our concerns, such as divestment undertakings.[131]

130. Where the issues are very straightforward and publishing a statement of preliminary issues is likely to delay our decision, we may choose not to do so.

131. We explain our approach to divestment undertakings further in Attachment F. We encourage applicants to offer divestment undertakings as early as possible. Where divestments are offered near the end of our investigation, we may need to request an extension to consider the impact of the proposed divestments. This could significantly extend our timeframe for assessing a clearance application.

International mergers: sharing information and requesting waivers

6.56 For mergers affecting a number of jurisdictions, we may contact overseas competition authorities to inform them that we have received a clearance application. We may also exchange views on the merger if this does not involve sharing confidential information.

6.57 For trans-Tasman mergers, we have a specific Cooperation Protocol for Mergers Review with the Australian Competition and Consumer Commission.[132] Cooperation may include:

- 6.57.1 coordinating our processes;
- 6.57.2 sharing information provided by the applicant and third parties;
- 6.57.3 sharing our analysis; and
- 6.57.4 from time to time, gathering information on behalf of the other agency.

6.58 However, we cannot disclose confidential information without consent from the party that provided the information. For that reason we may request a waiver from parties so that we can disclose confidential information. We do this where it seems likely that:

- 6.58.1 information or evidence provided to overseas competition authorities may demonstrate a competition issue that requires further investigation; and
- 6.58.2 the exchange of confidential information will benefit the assessment of an application for clearance, or make it easier to identify appropriate divestment undertakings.

6.59 We encourage applicants (and, where appropriate, third parties) to agree to provide a waiver, as it generally speeds up the investigation process, ensures we are considering the same information as our counterparts and can reduce the need for us to make information requests.

6.60 However, whether a party grants a waiver is not relevant to our assessment of whether the merger is likely to substantially lessen competition.

Post-determination: publication of decisions and written reasons

6.61 Once we have completed our investigation, the Division makes a decision on whether to clear or decline to clear a merger. The Chair of the Division then signs a notice of clearance or decline of clearance.

6.62 We inform the applicant of our decision by telephone and then issue a media release and update the clearance register on our website. Where the applicant or target is listed on the New Zealand and/or Australian stock exchanges, we issue the media release outside of trading hours. We may also inform market participants and other interested parties of our decision.

6.63 We also publish written reasons to explain our decision, and to provide guidance for the business community.

6.64 While we draft written reasons during our investigation, we can only finalise these following our decision. This may mean that we do not publish written reasons on the day we issue our decision.

132. A copy of the protocol is available at www.comcom.govt.nz/international-relations

6.65 We do, however, recognise that businesses want to understand the reasons for our decisions as soon as possible, particularly when we decline clearance. Because of this, we aim to publish reasons as soon after our decision as we are able. Where we have declined clearance, we aim to publish the reasons within 10 working days.[133]

Confidentiality

6.66 All information we receive is subject to the principle of availability under the Official Information Act 1982 (the Official Information Act).

6.67 However, the Official Information Act does not require us to disclose information if it would prejudice our investigations, or where the public interest in making the information available is outweighed by the fact that, in our view:

6.67.1 disclosure would unreasonably prejudice the commercial position of the supplier or subject of the information; or

6.67.2 we received the information under an obligation of confidence, and if we were to make that information available it would:

6.67.2.1 prejudice the supply of similar information to us (by any person) where it is in the public interest that such information continues to be supplied to us; or

6.67.2.2 be likely otherwise to damage the public interest.[134]

6.68 We acknowledge that much of the information we seek during our investigations will be commercially sensitive. We also recognise that this information is generally highly relevant to our investigation. As such, we recognise that preserving the confidentiality of commercially sensitive information and providing protection against disclosure is necessary. This ensures that parties continue to supply such information to us and that we can deal with clearance applications as quickly and efficiently as possible.

6.69 That said, because we aim to carry out our investigations quickly, transparently and adhering to the principles of natural justice, we take a cautious approach in accepting assertions of confidentiality. We test all claims to ensure that the information provided is truly commercially sensitive.

6.70 We also encourage parties to provide us with a public version of any submission made, which can then be viewed by the applicant and interested parties.[135] We discuss this with parties on a case-by-case basis.

6.71 In some cases, we may need to test confidential information provided by one party with the applicant or other interested parties. If possible, we hypothetically test the confidential information to avoid disclosure.

133. Parties may wish to appeal a decision. The High Court Rules provide that a party must file any appeal within 20 working days of the date on which the decision is made. As the decision date will often be different to the date on which we publish our reasons, we generally indicate to parties that we will not oppose a party filing an appeal out of time provided they file any appeal within 20 working days of the date on which we publish our written reasons.

134. While we have the discretion to issue a confidentiality order under s 100 of the Commerce Act to prohibit the publication or communication of certain information, we very seldom do so. This is because the information would already be protected by the obligations of confidence and the exceptions to disclosure obligations in the Official Information Act, and because a s 100 order expires 20 working days from the date of a determination, and so it will not protect information on an ongoing basis.

135. We may also publish public versions of submissions on clearance applications on our website.

Attachment A: Glossary

Complementary products – products for which the demand for one product increases if the price of the other falls, such as computers and computer software.

Conglomerate merger – a merger between firms that supply products that may relate to each other, for example, complementary products.

Coordinated effects – coordinated behaviour involves firms recognising that they can reach a more profitable outcome if they accommodate each other's price increases. Firms may coordinate their behaviour on price, customer or territory allocation, or any other dimension of competition.

Countervailing power – countervailing power exists when a customer possesses special characteristics that give that customer the ability to substantially influence the price the merged firm charges.

Differentiated products – products with some common functionality that have different characteristics in the eyes of customers.

Foreclosure – arises when a firm can no longer compete as effectively, due to less access or access on worse terms to customers or inputs.

Homogeneous products – products that have substantially the same characteristics as one another in the eyes of customers.

Hypothetical monopolist test – the main way we define markets. This test asks whether a hypothetical sole supplier of a set of products (or locations) would profitably increase prices for at least one of the merging firms' products (or locations) by a SSNIP. In general, the smallest set of products (or locations) in which the SSNIP can be profitably sustained is defined as the relevant product (or geographic) market.

LET test – a test to assess the potential for entry or expansion in a market. The LET test is satisfied when entry or expansion in response to a price increase or other exercise of market power is Likely, and sufficient in Extent and Timely enough to constrain the merged firm.

Market power – the ability to profitably and sustainably price above cost (including cost of capital and other relevant opportunity costs).

Merger – we use merger in these guidelines to cover any acquisition of shares or assets of a business, no matter what the form. The term also covers partial acquisitions.

Monopsonist – a single buyer.

Price – in these guidelines we use the term price as shorthand for all dimensions of competition, including quality, range, level of innovation and service.

Price discrimination – the practice of charging different prices to different customers, where such differences are not related to variations in the costs of serving customers.

Products – goods and services.

SSNIP – a Small, but Significant, Non-transitory Increase in Price.

Market share and concentration indicators – levels of market concentration and market shares under which a substantial lessening of competition is less likely to arise.

Substantial lessening of competition – a loss of competition that adversely affects consumers in the relevant market in a material way.

Substitute products – products for which the demand for one product decreases, if the price of other product falls.

Unilateral effects – unilateral effects arise when the merger removes a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.

Vertical merger – a merger between firms operating at different levels of the supply chain in an industry, for example, a merger between a wholesaler and a retailer of a particular product.

Attachment B: Documents and other information that we find useful in assessing whether mergers substantially lessen competition

Documents and other information

B1. When assessing a merger's effect on competition we seek information from customers, competitors, and other interested parties.

B2. We examine parties' statements and submissions and assess these against the documents and other information put forward by the parties. We give less weight to a statement or submission that a party cannot support with corroborating evidence, than a statement or submission that a party can support with corroborating evidence.

B3. As a general rule the information we find most persuasive are business documents and records that were prepared in the ordinary course of business.

B4. We encourage merging parties to discuss with us at the earliest opportunity, and ideally before the parties file a clearance application,[136] the types of evidence that we might find helpful in our investigation. Providing information as early as possible will help us to progress our investigation in a more timely way.

B5. In this respect, we request certain documents as part of an application, namely:[137]

B5.1 transaction documents such as sale and purchase agreements, memoranda of understanding, share transfer documents and register of assets being transferred;

B5.2 company structure documents such as organisational diagrams and listings of shareholders and directors;

B5.3 financial statements for the three financial years prior to the current year; and

B5.4 documents showing the rationale/strategy for the merger.

B6. Other information we may look for can be summarised as follows.

B6.1 General information which explains market conditions and trends. This may include market reports or studies prepared by a merging firm or an independent third party, and market forecasts.

B6.2 Information on how the merging firms and other parties view their competitors. This may include documents that assess or describe competing firms, such as SWOT or competitor analysis, and regular reporting on business performance (eg, monthly sales reports).

136. See paragraphs 6.4-6.10 for further details on pre-notification discussions.

137. Not all of these documents may be relevant in every case.

B6.3 Information on customers, and their preferences and behaviour. This may include information about recent tenders, such as who bid and who won, information about customers switching between suppliers, such as reports on customer churn, and customer surveys and forecasts.

B6.4 Strategy documents and financial information, such as research and development plans, investment proposals, business plans and financial projections, marketing and advertising strategies, and financial reports specific to the product(s) or geographic region(s) we are interested in.

B6.5 Information on how a party determines its pricing. This can include price lists, forecasts, analysis and strategies, discount/rebate policies, and examples of how pricing decisions have been made in the past and what factors influence those decisions.

Data for quantitative analysis

B7. In addition to examining information and documents, we may also carry out quantitative analysis to assist our decision making. We may carry out and rely on a quantitative analysis, if the analysis is likely to help clarify the issues in the case and appropriate reliable data is available.

B8. Our quantitative analysis can take many forms and may include: estimating diversion ratios, estimating own- and cross-price demand elasticities, identifying 'natural experiments' which allow us to compare prices (or non-price factors) in different time periods or different geographic areas characterised by different competitive conditions, merger simulations, and assessing the profitability of entry or expansion.

B9. The data we need to undertake these types of analysis differs depending on the type of analysis we are undertaking. However, we typically seek data capturing one or more of price, discounts, rebates, costs, quantities and margins. The extent to which we prefer this data to be aggregated or disaggregated depends on the analysis we are undertaking and the data available.

B10. Our preference is to obtain data over a three year period, although in some cases a longer or shorter timeframe might be more appropriate.

B11. Before requesting data we generally discuss our data requirements with the parties so that we can better understand what data is available and the easiest way it can be provided to us.

Attachment C: Acquisition of partial ownership/control in a firm

C1. Most of the mergers we consider involve one firm acquiring total ownership and control of another firm. However, a merger may involve a firm acquiring only partial ownership and/or control. This attachment explains how we assess this type of merger.

C2. There are three ways that an acquisition of partial ownership/control of a firm may substantially lessen competition. A merger may raise one, two or all potential concerns discussed below.

Substantial degree of influence

C3. First, an acquisition of partial control can substantially lessen competition by giving the acquiring firm a substantial degree of influence over the target firm's business decisions. We assess the prospect for a merger to lead to a substantial degree of influence, using the approach explained at paragraphs 2.4-2.9. The acquiring firm may have the incentive to use this influence anti-competitively, so that the merger may have the likely effect of substantially lessening competition.

Share of profits may change an acquiring firm's incentives

C4. Secondly, where a firm acquires partial ownership of another firm and in doing so acquires a share of the other firm's future profits, the acquiring firm's incentives may change. This change in incentives may result in the likely effect of substantially lessening competition. This is illustrated in the example below.

C5. Partial ownership may make it profitable for firm A to increase its prices. This is because when firm A is contemplating a price increase, it takes into account the fact that it is likely to regain a portion of the profits on the sales it loses to firm B through its rights to firm B's profits as a result of its partial ownership. This additional benefit may be sufficient to tip the balance in the weighing exercise between lost sales due to a price increase and increased margin on continued sales such that a price increase is rendered profitable.

Increased potential for coordination

C6. Thirdly, partial ownership may increase the potential for firms to coordinate their behaviour and collectively exercise market power, thereby substantially lessening competition in a market.

C7. This assessment is parallel to, but informed by, our assessment of pre-existing interconnection and association in an industry (see above paragraphs 2.4-2.9) and our assessment of existing relationships that may affect relevant firms' incentives to compete (see above paragraph 3.80).

Attachment D: Market share and concentration indicators

D1. As discussed at paragraphs 3.50-3.55, we use market share and concentration indicators to help merging firms assess whether an application for clearance may be necessary.

D2. The first step in applying these indicators is to define the relevant market. As these indicators are based on market shares, if there is uncertainty about the appropriate market definition, the market definition that results in the worse case market share aggregation when applying the indicators should be adopted.

D3. To apply the indicators, we calculate two measures.

D3.1 First, we calculate the combined market shares of the merging firms. Market shares can be measured in a number of different ways (see paragraphs 3.56-3.60 above). Merging firms should select the market share measure which best reflects how market participants view market shares.

D3.2 Second, we calculate the combined market shares of the three largest parties in the relevant market as a percentage of the total size of the market. This is called 'the three firm concentration ratio'.

For example, in a market composed of five firms with annual sales of \$35m, \$30m, \$20m, \$10m and \$5m, the three concentration ratio (CR_3) would be calculated as follows:

$$CR_3 = \left(\frac{35 + 30 + 20}{35 + 30 + 20 + 10 + 5}\right)100 = \left(\frac{85}{100}\right)100 = 85\%$$

D4. The examples below apply the market share and concentration indicators to two hypothetical situations.

Examples where the three largest firms have 70% or more of the market

D5. As an initial guide, a merger is unlikely to require a clearance application if post-merger the three largest firms in the market have a combined market share of 70% or more, and the merging firms' combined market share is less than 20%.

D6. In Table 1, the combined market share of the three largest firms is 70% prior to the merger. We explain two examples: in the first, the merger exceeds the indicators; in the second, the merger is within the indicators.

Firm	Pre-merger market share (%)		Combined market share (%) Example 1		Combined market share (%) Example 2	
A	30		30		30	71%
B	22	70%	22	81%	22	
C	18		29		18	
D	11				19	
E	8		8			
Other firms with market share less than 10%	11		11		11	
Total market	100		100		100	

D7. In example 1, firms C and D merge, and the three firm concentration ratio post-merger is 81%. As this is greater than 70%, the combined market share of the merging firms must be less than 20% to fall within the indicators. The combined share is 29% for this merger and so the merger does not fall within the indicators.

D8. In example 2, if firms D and E were to merge, the post-merger three firm concentration ratio would be 71%. This is more than 70% but the combined market share of the merging firms is less than 20% (19%), so the merger would fall within the indicators.

Examples where the three largest firms have less than 70% of the market

D9. A merger is within the indicators if post-merger the three largest firms in the market have a combined market share of less than 70%, and the combined market share of the merging firms is less than 40%.

D10. In Table 2 the combined market share of the three largest firms is 56% prior to the merger. We explain two examples: in the first, the merger exceeds the indicators; in the second, the merger is within the indicators.

<table>
<tr><th>Firm</th><th colspan="2">Pre-merger market share (%)</th><th colspan="2">Combined market share (%) Example 1</th><th colspan="2">Combined market share (%) Example 2</th></tr>
<tr><td>A</td><td>20</td><td rowspan="3">56%</td><td rowspan="2">45</td><td rowspan="4">66%</td><td>20</td><td rowspan="4">66%</td></tr>
<tr><td>B</td><td>25</td><td rowspan="2">36</td></tr>
<tr><td>C</td><td>11</td><td>11</td></tr>
<tr><td>D</td><td>10</td><td></td><td>10</td><td>10</td></tr>
<tr><td>E</td><td>5</td><td></td><td>5</td><td></td><td>5</td><td></td></tr>
<tr><td>Other firms with market share less than 10%</td><td>29</td><td></td><td>29</td><td></td><td>29</td><td></td></tr>
<tr><td>Total market</td><td>100</td><td></td><td>100</td><td></td><td>100</td><td></td></tr>
</table>

D11. In example 1, firms A and B merge, and the three firm concentration ratio rises to 66%. Although this is below the 70% mark, the merger does not fall within the indicators as the combined market shares of the merging firms (45%) is greater than 40%.

D12. In example 2, if firms B and C were to merge, this merger would fall within the indicators as the three firm concentration ratio (66%) is less than 70%, and the combined market share of the merging firms (36%) is less than 40%.

Attachment E: How we assess failing firm arguments

E1. This attachment explains how we assess failing firm arguments and the types of information that applicants should provide to support such arguments.

E2. We sometimes receive clearance applications that claim we should clear an otherwise potentially anti-competitive merger because one or more of the merging firms is failing, or has a failing division, and its assets will leave the market without the merger. This is commonly called a 'failing firm argument'.

E3. If a firm is in fact failing and its assets will leave the market without the merger, there is likely to be no material difference between the scenarios with and without the merger. As a result, the merger will not substantially lessen competition. We may clear a merger if there is sufficient evidence to support a failing firm argument.

E4. We will not, however, accept failing firm arguments without close scrutiny.

How we assess failing firm arguments

E5. When assessing failing firm arguments, we ask these questions.

E5.1 Has the firm (or division) ceased operations or will it cease operations imminently or probably?[138]

E5.2 What will likely happen to the assets of the firm (or division) without the merger? Will the assets likely exit the market?

Has the firm (or division) ceased operations or will it cease operations imminently or probably?

E6. When assessing whether a firm has or is likely to cease operations, we ask questions including the following.

E6.1 Has the firm or division had a trend of negative cash flows over a sustained period of time? (In some cases the firm may already be in liquidation.)

E6.2 Is there any prospect of restructuring or refinancing the firm or division?

E6.3 Has the failing firm or its owners made reasonable efforts to rescue the firm or division?

E7. Sometimes merging firms claim that a division of a firm is failing. Such cases require particular care because a firm can allocate costs and revenues across its subsidiaries, branches and divisions, including by way of intra-company transactions or transfers.

138. *New Zealand Co-operative Dairy Co Ltd* [1991] 4 TCLR 134.

What will likely happen to the assets of the firm (or division) without the merger?

E8. When assessing what will likely happen to the firm's (or division's) assets without the merger, we ask questions including the following.

- E8.1 On closure, will the firm's (or division's) assets likely exit the market (either by becoming scrap or being put to an alternative use)?
- E8.2 Is it likely that a credible third party will acquire the firm (or division) as a going concern?[139]
- E8.3 Has the failing firm or its owners made reasonable efforts to find a third party purchaser for the firm, the division, or its assets?

Supporting evidence

E9. We take a rigorous approach to the types of evidence we expect to see in support of a failing firm argument. Situations where firms face declining sales or profits, or where the earnings rate is significantly below the shareholders' expectations, would, in isolation, be unlikely to satisfy us that the firm is failing.

E10. Below we list examples of the type of evidence we expect to see to support any failing firm arguments. The lists below are not exhaustive and not all of these types of evidence will necessarily be applicable in every case.[140]

E11. Merging firms should provide the necessary information in a timely manner, to allow us to investigate and reach a decision. This is particularly the case if merging firms are seeking an urgent decision.

E12. We recognise that in some cases events have evolved rapidly and that the merging firms might not have had the opportunity to prepare particular documents. Nevertheless, we need to examine the facts.

E13. When merging firms contemplate a clearance application that includes a failing firm argument, we encourage them to contact us as soon as possible so that Commission staff can help identify the types of evidence required.[141]

139. In general terms, we consider a scenario where a credible competing buyer acquires the target, an unlikely scenario if that buyer's acquisition would raise competition concerns. See paragraph 2.40 for more information.

140. Some evidence may only be available from the target firm.

141. For details about pre-notification discussions, see paragraphs 6.4-6.10.

Evidence that the firm (or division) has ceased operations or will cease operations imminently or probably

E14. When assessing whether a firm or division has ceased operations or will cease operations imminently or probably, the following evidence may be useful.

E14.1 Evidence that the firm has been liquidated or placed into administration.

E14.2 Financial statements of the firm or division in question (those that have been audited if available) and/or management accounts.

E14.3 Budgets and forecasts for the current year and future years.

E14.4 Volume / demand data (trend analysis).

E14.5 Board minutes and papers concerning viability.

E14.6 Internal strategic plans.

E14.7 Capital expenditure proposal documents.

E14.8 Documents regarding initiatives or plans to restructure or improve the firm (or to reduce costs).

E14.9 Asset valuation reports.

E14.10 Independent appraisals of the firm.

E14.11 Costs of exit or closure.

Evidence about what will likely happen to the assets of the firm (or division) without the merger

E15. When assessing what will likely happen to the assets of the firm (or division) without the merger, the following evidence may be useful.

E15.1 Evidence of genuine efforts to sell either the firm as a going concern or its assets on closure.

E15.2 Any offers for the firm.

E15.3 Identity of likely purchasers and the timeframe under which an alternative transaction would likely take place.[142]

E16. Where claims that a division is failing are submitted, we find the following additional types of information useful.

E16.1 Corporate costs allocated to the failing firm (or division), including any intra-corporate transactions or transfers.[143]

E16.2 Details of the principles underlying the approaches used for intra-corporate cost allocations and transactions.

142. We may contact potential purchasers to assess the nature of their interest.

143. This includes all corporate common costs, such as overheads and management fees, charged to the failing firm.

Examples of our approach

E17. For examples of our approach, please see the following decisions, which can be viewed on our website www.comcom.govt.nz/clearances-register:

E17.1 DFS Group Limited and The Nuance Group (Commerce Commission Decision 638, 28 March 2008);

E17.2 The Southern Cross Health Trust and Aorangi Hospital Limited (Commerce Commission Decision 650, 4 September 2008);

E17.3 Shell New Zealand Limited and Mobil Oil New Zealand Limited (Commerce Commission Decision 655, 10 October 2008);

E17.4 Fletcher Building Limited and Stevenson Group Limited (Commerce Commission Decision 663, 13 February 2009); and

E17.5 PMP Print Limited and APN Print NZ Limited (Commerce Commission Decision 708, 16 December 2010).

Attachment F: How we assess whether divestment undertakings may remedy competition concerns

Purpose

F1. This attachment explains how we assess whether divestment undertakings may remedy competition concerns arising from a merger in the context of a clearance application. Specifically, it explains:

F1.1 the relevant legal framework;

F1.2 how we analyse divestment undertakings;

F1.3 our process for considering divestment undertakings; and

F1.4 the type of content the divestment undertaking may include, and the timeframe for divesting assets/shares.

The legal framework for divestment undertakings

F2. Where a merger raises competition concerns, an applicant can provide an undertaking to sell certain assets or shares as a condition of clearance in order to remedy those competition concerns.[144]

F3. We can only accept undertakings to divest assets[145] or shares.[146]

F4. It is up to an applicant to decide whether to offer a divestment undertaking. An applicant may offer an undertaking at the time of application, or at any stage during our investigation.

F5. If we accept a divestment undertaking, then it is deemed to form part of the clearance given.

What happens if an applicant does not comply with a divestment undertaking

F6. We monitor an applicant's compliance with a divestment undertaking.

F7. If a divestment undertaking is contravened (eg, the divestment does not occur), the clearance to which the undertaking relates is void from the date it was granted.[147] This means that the merger can be challenged in the High Court by us or a third party on the grounds that the merger has the effect or likely effect of substantially lessening competition.

144. Commerce Act 1986, s 69A.

145. Section 2(1) of the Commerce Act 1986 states that assets include intangible assets.

146. Under section 2(1) of the Commerce Act 1986, share means "a share in the share capital of a company or other body corporate, whether or not it carries the right to vote at general meetings; and includes—

(a) A beneficial interest in any such share;

(b) A power to exercise, or control the exercise of, a right to vote attaching to any such share that carries the right to vote at meetings of the company;

(c) A power to acquire or dispose of, or control the acquisition or disposition of, any such share;

(d) A perpetual debenture and perpetual debenture stock."

147. Commerce Act 1986, s 69AB.

F8. If we are satisfied that an applicant has contravened an undertaking, we can apply to the Court for a divestment order.[148] We do not need to establish that a merger will substantially lessen of competition in a market in order to be able to enforce a divestment undertaking.

F9. We may also:

F9.1 seek an injunction restraining the person from completing the merger (if it has not been completed);[149] or

F9.2 apply to the Court for pecuniary penalties for a contravention of an undertaking.[150]

Varying undertakings

F10. If for any reason an applicant considers it cannot meet a term of a divestment undertaking, it should contact us as soon as possible. We may, on application, accept a variation of an undertaking if we consider that the variation would not have materially affected our decision to clear the merger.[151]

F11. An applicant must apply to vary an undertaking no later than 20 working days before the date on which it must meet the relevant obligation under the undertaking.

How we analyse divestment undertakings

F12. Where we consider that a merger is likely to substantially lessen competition in the relevant market(s), we consider whether the proposed divestment undertakings will remedy that likely substantial lessening of competition. For a divestment undertaking to remedy competition concerns, we must be satisfied that the divestment will result in sufficient additional competitive constraint on the merged firm so that a substantial lessening of competition is no longer likely.

F13. In making this assessment, we consider all the relevant risks associated with divestment proposals. These risks arise because a divestment undertaking's impact will be felt in the future. Therefore, there will always be some uncertainty about an undertaking's likely impact on the relevant market. It follows that there will also be some uncertainty whether a divestment will actually remedy the competition concerns raised by the merger.

F14. In order to assess these divestment risks, we compare the situations with and without the divestment undertaking. We assess whether the divestment would, of itself, or in combination with other market conditions, likely remedy the competition concerns that have been identified.

148. Commerce Act 1986, s 85B.

149. Commerce Act 1986, s 84. Alternatively we may seek a Cease and Desist Order from the Cease and Desist Commissioner, Commerce Act 1986, s 74A.

150. Commerce Act 1986, s 85A.

151. Commerce Act 1986, s 69AC.

F15. We assess three kinds of risks associated with divestment undertakings.

F15.1 Composition risk – the risk that the scope of a divestment undertaking may be too constrained, or not appropriately configured, to attract a suitable purchaser.

F15.2 Asset risk – the risk that the competitive effectiveness of a divestment package will deteriorate prior to completion of the divestment.

E15.3 Purchaser risk – the risk that there may not be a purchaser acceptable to the Commission available and/or the risk that the applicant has an incentive to sell to a weak competitor.

F16. The composition, asset and purchaser risks are all inter-related and we assess them on that basis. We carry out each assessment on a case-by-case basis.

F17. To ensure that the divestment undertaking will remedy any competition concerns identified, the applicant must provide evidence that addresses these risks. This enables us to be satisfied that the proposed acquisition, together with the divestment, will be unlikely to substantial lessen competition.

F18. We explain composition, asset and purchaser risks below.

Composition risk

F19. As noted above, composition risk is the risk that the scope of a divestment undertaking may be too constrained, or not appropriately configured, to attract a suitable purchaser.

F20. Composition risks vary from case to case. We consider the following factors, among others, in assessing composition risk.

F20.1 Is the separation of the assets to be divested practically achievable within the timeframe specified in the undertaking?

F20.2 Are all the assets necessary for the purchaser to be able to operate a viable and competitive entity included in the divestment undertaking? We prefer the divestment of an existing business entity or unit that has already demonstrated its ability to compete in the relevant market(s). An existing business entity should ideally contain all the physical assets, relevant personnel, customer lists, information systems, intangible assets and management infrastructure required.

F20.3 Where the applicant is offering to divest assets or shares that belong to the target, has the applicant sufficient and relevant information about the target's assets or business?

F21. An example of how an applicant can address composition risks is set out below.

EXAMPLE

Gallagher Holdings Ltd and Tru-Test Corporation Limited

Commerce Commission Decision 545, 23 February 2005

Gallagher Group Holdings Limited (Gallagher) sought clearance to acquire up to 100 per cent of the ordinary shares of Tru-Test Corporation Limited (Tru-Test). The application stated that Gallagher would undertake to divest the 'Stafix' brand of electric fencing, post-merger; Stafix was one of Tru-Test's major electric fence brands.

We examined the composition risks of the proposed divestment undertaking of the Stafix brand. The key composition risk was whether the scope of the divestment undertaking would allow Stafix's new owner to be an effective competitor in the electric fencing market.

An important complication with this divestment was that Gallagher did not own the Stafix brand but still had to satisfy us that the composition of the assets would be competitively effective.

Gallagher addressed our concerns by providing evidence that:

- the manufacture of Stafix could be outsourced;
- Stafix's new owner would have all of Stafix's key products; and
- Stafix's new owner would have royalty-free access to all intellectual property necessary to manufacture the Stafix products.

Overall, we were satisfied that the composition of the divestment undertaking was sufficient to ensure that Stafix's new owner would be an effective competitor in the electric fencing market.

Asset risks

F22. As noted above, asset risk is the risk that the competitive effectiveness of a divestment package will deteriorate prior to completion of the divestment. Possible causes of erosion of competitive effectiveness that we might consider include:

F22.1 reduced marketing and sales efforts arising from employee-related factors, including possible distraction from normal duties as a result of the sale process; and

F22.2 the applicant having an incentive to weaken the competitive effectiveness of the divested assets, thereby reducing a new owner's ability to compete post-divestment.

F23. Applicants should provide sufficient evidence to allay concerns about the above asset risks when offering an undertaking. For example, the applicant may include a term in the undertaking that:

F23.1 the applicant will appoint an independent manager to ensure that the competitive value of the assets to be divested is maintained; and/or

F23.2 specifies a short timeframe for divestment to take place.

F24. An example of how an applicant can address asset risks is set out below.

EXAMPLE

Schering-Plough Corporation and Organon BioSciences N.V.

Commerce Commission Decision 621, 4 October 2007

On 5 July 2007 Schering-Plough Corporation (Schering-Plough) applied for clearance to acquire 100 per cent of the shares in, or assets of, Organon BioSciences N.V. (Organon BS).

After that, Schering-Plough provided a divestment undertaking. The undertaking stated that Schering-Plough would undertake to divest the Campylovexin campylobacter vaccine business after the merger.

We spoke with a number of industry participants including veterinarians, existing competitors, and potential buyers in respect of the Campylovexin vaccine. Campylovexin was in general viewed as reliable and effective, and a strong competitor in the campylobacter vaccine market. However, some viewed it as a declining product, which was inferior to its competitor, Organon BS product Campyvax4. Notwithstanding Campylovexin's generally solid reputation, we identified a number of asset risks.

A major asset risk was the potential for the competitive effectiveness of Campylovexin (and so sales) to decline during the period between the merger and the completion of the divestment.

A decline in Campylovexin's market share and competitiveness during the divestment period might have resulted from the following factors:

- uncertainty in the market about the continued supply of Campylovexin;
- a disincentive to promote or maintain the Campylovexin brand after acquiring control of Campyvax4; and
- incentives for the merged firm to switch customers to Campyvax4.

We considered that the timing of the divestment allayed concerns regarding the asset risks. A maximum six month period over which the divestment had to be completed (or by 31 May 2008, whichever occurred earlier) meant that Schering-Plough would only market both vaccines for a short period. Also, this time period fell after the season in which campylobacter vaccines were most heavily marketed.

Purchaser risks

F25. We assess two main purchaser risks, namely that:

F25.1 a purchaser acceptable to the Commission may not be available;[152] and/or

F25.2 the applicant has an incentive to sell to a purchaser that is not competitively effective, even though a more competitively effective purchaser may be prepared to pay a relatively higher price.

152. For example, when deciding whether to clear a merger on the basis of an undertaking, we assess whether there may be little or no interest from potential purchasers. This might indicate that the assets are unattractive to potential purchasers which may cast doubt on the effectiveness of the undertaking.

F26. A purchaser acceptable to the Commission is likely to have all of the following attributes.

F26.1 It is independent of the merged firm.

F26.2 It possesses or has access to the necessary expertise, experience and resources to be an effective long-term competitor.

F26.3 The acquisition of the divested shares or assets by the proposed buyer does not raise competition concerns.

F27. Possible ways in which an applicant could allay purchaser risk concerns include, but are not limited to, the following.

F27.1 Ideally, the applicant offers to divest to a named buyer before the Commission makes its decision. In this instance, we would assess whether the proposed buyer is acceptable to us (ie, has the attributes we expect). If we are satisfied that this is the case, and the asset and composition risks are addressed, the divestment undertaking that forms part of the clearance will include the buyer as the named purchaser.

F27.2 If no buyer is identified before we make a clearance decision, the applicant includes in its divestment undertaking that it:

F27.2.1 will divest the assets/shares to a buyer that is acceptable to us within a specified timeframe;[153] and

F27.2.2 will inform us of the proposed buyer's identity prior to entering into a binding contract for sale and purchase of the shares/assets, providing reasons and evidence that establish that the buyer is likely to provide sufficient competition post-merger.

F27.3 The applicant could also include in its divestment undertaking a clause stipulating that if the divestment does not take place within the specified timeframe, it:

F27.3.1 will appoint an independent sales agent to divest the assets at no minimum price to a buyer acceptable to us;[154] and

F27.3.2 will inform us of the proposed buyer's identity prior to entering into a binding contract for sale and purchase of the assets/shares, providing reasons and evidence that establish that the buyer is likely to provide sufficient competition post-merger.

F28. Under the second and third scenarios where there is no upfront buyer, we assess whether a purchaser acceptable to us is likely to be available when deciding whether or not to give clearance.

F29. When the applicant identifies a buyer and asks us to approve the purchaser, we then consider whether that proposed purchaser is acceptable to us and we communicate our decision to the applicant. If we decide that the proposed buyer is not acceptable for any reason, the applicant may propose an alternative purchaser.

153. The undertaking may specify the attributes a purchaser must possess to be acceptable to us.

154. In that event, the agent's mandate will be discussed and agreed with the applicant on a case-by-case basis.

F30. An example of how an applicant can address purchaser risks is set out below.

EXAMPLE

Transpacific Industries Group (NZ) Limited and Ironbridge Capital Pty Limited

Commerce Commission Decisions 622, 623, 624 and 625, 31 October 2007

In August 2007, Transpacific Industries Group (NZ) Limited (TPI) filed four separate applications seeking clearance for it to acquire from Ironbridge Capital Pty Limited (Ironbridge) EnviroWaste Services Ltd's (EnviroWaste) solid waste collection businesses in (1) Blenheim and Nelson, (2) Timaru and Oamaru, (3) Christchurch, and (4) Dunedin.

Having investigated and analysed the relevant markets, we identified a number of competition concerns which we communicated to TPI.

Subsequently, TPI discussed with us the possible divestment of certain assets. TPI identified three parties to acquire these assets. We were of the view that the competition concerns were unlikely to be allayed if any one of these parties acquired the assets. We communicated this to TPI.

Eventually, TPI provided an undertaking that it would divest the relevant assets to another purchaser up-front. We considered the proposed purchaser would provide TPI with a considerable degree of competitive constraint post-divestment. We were therefore satisfied that there was no purchaser risk in that case.

Our process for considering divestment undertakings

F31. This section sets out the process we follow when considering divestment undertakings including:

F31.1 the benefits of early notice and pre-notification discussions;

F31.2 our process if we have competition concerns not remedied by any undertakings already offered;

F31.3 our process if the applicants have offered undertakings and we do not have concerns; and

F31.4 our liaison with overseas jurisdictions.

Inform the Commission early

F32. We encourage applicants to offer divestment undertakings as early as possible if applicants consider that a divestment undertaking may prevent the proposed merger from substantially lessening competition in the relevant market(s).

F33. When divestments are offered as part of a clearance application, we can assess the merger's likely effects taking into account divestments from the start of the process. If divestments are offered near the end of our assessment, we may need to request further time to consider the merger in light of the proposed divestment.

F34. Before making any application applicants can discuss the merger and application with us (pre-notification discussions).[155] Based on the information provided by applicants, we may discuss the possibility of divestment undertakings at this stage. However, any feedback given to applicants at that stage would be our preliminary view only.

Our process if we have competition concerns not remedied by any undertakings already offered

F35. If we identify any competition concerns that are not remedied by any undertakings offered, we set these out in a letter of issues and, if necessary, a subsequent letter of unresolved issues to the applicant.[156] The letters may also:

F35.1 include any issues raised by any proposed divestment undertakings; and

F35.2 suggest to the applicants that they consider additional divestment undertakings as a possible means of resolving the identified competition concerns.

F36. While we identify the expected competitive harm in any such letters, we do not seek to design the divestment undertaking, ie, we will not identify particular assets/shares to be divested. The applicant and its advisers are usually in the best position to do this. However, we are available to discuss the terms of a proposed divestment undertaking if it enables the applicant to structure or vary the terms of the divestment undertaking to remedy our competition concerns.

Our process if the applicant has offered undertakings and we do not have concerns or our concerns do not justify all the undertakings

F37. If the applicant has offered undertakings and we consider that remedying the competition concerns identified would not require all the undertakings offered, we will tell the applicant this. The applicant can then decide whether to withdraw or vary its divestment undertakings. However, this will solely be the applicant's decision.

155. See paragraphs 6.4-6.10.

156. See paragraphs 6.52-6.55.

EXAMPLE

Accepting divestments – Hypothetical example

The applicant (Retailer A) submits an application for clearance to purchase the assets and shares of a large retail outlet (Retailer B). Retailer A and Retailer B have a number of retail outlets around New Zealand and, in some locations, are direct competitors.

In its clearance application, Retailer A offers to divest four of its retail outlets in locations where Retailer B also has retail outlets. These locations are Whangarei, New Plymouth, Westport and Dunedin. This is to remedy any substantial lessening of competition in these specific locations.

Following investigation and analysis, we contact Retailer A to say that, subject to any new significant information or material changes in the markets, we have found that:

- without the divestment, there are no competition concerns in Westport and Dunedin; and
- competition concerns remain in Whangarei and New Plymouth which the current divestment undertakings are likely to remedy.

Retailer A may then vary its application and divestment undertakings, for example, by removing the offered undertakings to divest in Westport and Dunedin. It is Retailer A's choice as to content of the divestment undertakings. Retailer A may still opt to divest in all four locations.

Liaison with overseas jurisdictions

F38. The increasing number of global mergers has enhanced the need for communication, coordination, and cooperation among competition authorities in different jurisdictions.

F39. We may need to consult overseas competition authorities to ascertain whether divestments overseas will have an effect (either positive or negative) on competition in markets in New Zealand.

F40. We will seek a voluntary waiver from the applicant that allows us to exchange confidential information with overseas competition regulators before any confidential information is exchanged.

What information should be in a divestment undertaking and the timeframe for divesting assets

F41. A divestment undertaking should set out the obligations of the applicant to divest the assets/shares, including the timeframe in which the assets/shares must be divested. It should also specify all of the assets/shares to be divested and the identity of the acquirer, if known.[157]

F42. The shorter the divestment period, the less likely it is that factors such as the deterioration of assets/shares, the loss of customers and/or key personnel, or similar, will cause the divestment to be ineffective.

157. Other possible terms are discussed above at paragraphs F23 and F27.

F43. In general, we allow six months for an applicant to fulfil the terms of the divestment undertaking.

F44. However, the timeframe will vary in each case. We may require a shorter timeframe than six months if we consider that there are significant risks associated with the divestment. Conversely, we recognise that identifying potential purchasers may be time-consuming. We also recognise that potential purchasers themselves may require time to enter into a sale and purchase agreement due to the need to, for example, carry out due diligence or obtain the required financing. If this is the case, we may allow a longer divestment timeframe.

F45. In most cases, the timeframe for divestment will be kept confidential to prevent gaming by potential purchasers or an undesirable 'fire sale'.

F46. The applicant should keep us fully informed throughout the divestment timeframe as to the status of the assets/shares to be divested and the progress of the divestment generally. We will also monitor whether the applicant is on track to complete the divestment.

This is a guideline only and reflects the Commission's view. The publication is not intended to be definitive and should not be used instead of legal advice. It is businesses' responsibility to remain up to date with legislation.

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To check for updates to these guidelines visit: **www.comcom.govt.nz/mergers-and-acquisitions-guidelines**

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