

TENNEX SUBMISSION ON DRAFT DETERMINATION – 6 DECEMBER 2018

1 Tennex has reviewed the Commission’s draft determination dated 29 November 2018 (the *Draft Determination*). Tennex is broadly comfortable with the conclusions reached, but makes the following points ahead of the Commission making its final determination.

Counterfactual

2 In the Draft Determination, the Commission:

2.1 found that San-i-pak is likely to continue to operate in the relevant markets independently of Tennex and in competition with IWL;¹ and

2.2 did not accept that the closure of San-i-pak is a likely scenario.²

3 Tennex has limited visibility of the commercial aspirations of other prospective buyers, but it has obviously been approached by San-i-pak against a background of significant time having passed with those same prospective buyers not having executed a transaction. This context means there is a real question, regardless of the representations being made by prospective buyers now in the context of this application, as to whether there is in fact a real chance of San-i-pak continuing to operate independently of Tennex.

4 The period since the declined clearance application offers the best evidence of the likelihood of any deal. In that timeframe, agreement has not been reached despite there being a willing vendor and an opportunity to purchase with Tennex having been publicly excluded from participation. That indicates the likelihood of these buyers striking mutually agreeable commercial terms with the vendor is low. Whether that prospect equates to a “real chance” is a matter for the Commission to assess. At the very least, for the same reasons, Tennex submits that closure of San-i-pak is a likely scenario, indeed a much more likely scenario than continued operation under new ownership.

5 The Commission noted that Tennex has accepted that San-i-pak’s continued operation is a likely counterfactual.³ Tennex in fact accepted San-i-pak’s continued operation is a likely counterfactual **for the purposes of the Application**.⁴ Tennex has taken this position because, even using this scenario as a “conservative” basis for the analysis, it takes the view that the public benefits of the transaction comfortably outweigh any detriments.

6 Tennex remains comfortable that the Commission use a conservative counterfactual for conducting its preliminary competition analysis, given that the public benefit analysis remains broadly favourable. However, if the Commission’s view of the public benefits changes such that it finds a net detriment, then Tennex submits it would be necessary to round back on the counterfactual analysis to ensure the Commission has properly reconciled the fact of no transaction having happened to date with a finding that nonetheless, in the counterfactual, under similar conditions, there is a real chance that one would eventuate.

¹ Draft Determination at [51].

² Draft Determination at [48].

³ Draft Determination at [49].

⁴ Application at [24].

7 Finally, the Commission considers a third party owner would be likely to expand, although there is uncertainty as to the likely timing and extent of any expansion.⁵ Tennex notes that:

7.1 San-i-pak is a savvy commercial operator and it is difficult to see why the Commission would assume that under new ownership it would be any more effective in winning share from Tennex than it has been to date; and

7.2 The Commission should ensure that any capital investment required to facilitate such expansion is properly accounted for to the extent that it is avoided with the proposed transaction.

Competition analysis

Potential competition

8 The Commission focussed a significant part of its LET test analysis on Waste Management, who it considers well-placed to enter the relevant market. This entry could occur through, for example, bidding for large customer contracts.⁶

9 The Commission found there is a real chance that Waste Management does not win the Canterbury DHB contract.⁷ Tennex of course agrees with that assessment. Tennex would compete hard to retain the contract and would give itself at least a real chance of being successful. As the Commission recognises, it is not necessary for Waste Management to win the contract for it to have a significant competitive effect and be an effective constraint.⁸ It is sufficient that Tennex perceives this threat to be real, which it does.

10 The Commission finds that any constraint posed by Waste Management would be less than the constraint in the counterfactual.⁹ Tennex disagrees. The constraint would be different, but no less effective. The “additional cost and risk associated with establishing a new plant” overstates what would in fact be one-off transition costs not materially adverse to the competitive constraint. In fact, scale advantages and economies of scope mean that Waste Management’s constraint would likely be more effective than any posed in the counterfactual by a “real chance” prospective owner of San-i-pak.

Countervailing power

11 Tennex is not surprised that large customers have indicated they would not self-supply in the event of a price rise.¹⁰ However, large customers are able to defeat a price rise by partnering with an alternative provider. Waste Management agrees DHBs have this power.¹¹ In Tennex’s view, this is what guards against a lessening of competition.

12 The Commission remains of the view that small customers are still vulnerable to price increases, even if large customers do have countervailing power.¹² Tennex

⁵ Draft Determination at [52] and [53].

⁶ At [74].

⁷ At [74].

⁸ At [74.5].

⁹ At [74.5].

¹⁰ At [80].

¹¹ Waste Management submission of 17 October 2018 on the statement of preliminary issues, at [8].

¹² Draft Determination at [82], citing *Tennex Capital Limited and San-i-pak Limited* [2016] NZCC 5.

notes there is no evidence that small customers are charged more in Christchurch than in areas where there is a single provider and there is no reason to expect Christchurch to be any different in the counterfactual. As the Commission is aware, []]. Competitive pressure applied across the country not only constrains price increases, but ensures that the benefits of the transaction will be shared with consumers.

- 13 Even if the Commission, having had regard to these submissions, makes a finding that the transaction will result in a lessening of competition, Tennex notes that all of these factors are still relevant to the consideration of whether or not to implement a modified total welfare standard. More specifically, each of these factors operates to give comfort that the benefits arising from this transaction will over time be shared with consumers. See further from paragraph 19 below.

Benefits and detriments

- 14 Tennex submits it is inappropriate to discount the transaction's capital cost savings on the basis that certain benefits would be available absent the transaction, were a third party to acquire San-i-pak. Tennex is not aware of the existence of a "real chance" purchaser with available synergies that would lessen the claimed benefits. Tennex understands that material synergies are not available to those parties that San-i-pak considers as potential buyers.
- 15 The Commission acknowledges it "cannot exclude a real chance there would not be some opportunity cost" for a third party purchaser of San-i-pak looking to realise synergies.¹³ There must be more than a real chance of opportunity cost. It is certain that any party looking to deploy resources into this market who is not already wholly focussed on it would face an opportunity cost that must be factored in.
- 16 The Commission finds that there will be no significant benefit from more robust treatment of waste.¹⁴ Tennex understands the Commission's position but notes that the benefits attributed to avoided capital costs must reflect this finding, by accounting for construction of a fully compliant plant.
- 17 The Commission calculated that average prices were []% higher in Wellington than in Christchurch and used this as its lower bound for possible price increases. Tennex notes that, while there are a range of factors that impact pricing in different regions, it understands the calculation the Commission has made in principle. However, its commercial view is that it will not be able to implement price rises of this magnitude. Accordingly, that []% figure would be better used as the upper bound of possible price increases. The []% figure proposed in the Draft Determination should not be the upper bound. It does not seem to be based on any principled calculation and from a commercial perspective is unachievable. There is no evidence, for example, that the Upper South Island market will be any more vulnerable to price rises than the Lower North Island is currently.
- 18 The Commission notes that an alternative purchaser of San-i-pak expanding the scale or geographic scope of the business may result in greater competition more broadly in the South Island.¹⁵ Tennex submits this is not likely to happen in the

¹³ Draft Determination at [102.2.3].

¹⁴ At [119].

¹⁵ At [142].

counterfactual. The best evidence of what might be expected from a new owner of San-i-pak is that it has not happened for a long time under current ownership. As the Commission recognised,¹⁶ San-i-pak is profitable on its current footprint, and that can be expected to continue. The Commission should not overstate the chance of a third party owner expanding an already profitable business into less dense and more remote centres in the South Island that already have an effective and efficient incumbent provider.

Modified total welfare standard

- 19 The Commission has asked for views on whether a modified total welfare approach is appropriate. Tennex has already submitted that it is not and remains of that view.
- 20 As set out above, Tennex considers that a significant proportion of the merged entity's business comes from large customers with significant countervailing power both to negotiate prices, and to partner with another supplier – like Waste Management – should they be dissatisfied with the offering of the merged entity.
- 21 Those customers, a district health board and an international airport, supply services to almost as wide a range of consumers as possible. Their countervailing power ensures they and their consumers can expect to share in the benefits of the merger over time.
- 22 Further, as referenced earlier, [] ensures that small players benefit from the pressure faced in the most competitive parts of the country.

¹⁶ At [51.1].