

COMMERCE COMMISSION

Decision No. 442

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

UNITED ENVIRONMENTAL LIMITED

and

SOLVENT SERVICES LIMITED

The Commission: PR Rebstock
PJM Taylor
DF Curtin

Summary of Application: The acquisition by United Environmental Limited of all the assets of the business of Solvent Services Limited.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.

Date of Determination: 5 October 2001

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THE PROPOSAL

1. On 24 August 2001 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 (the Act), from United Environmental Limited (UEL and the Applicant) to purchase all the assets of Solvent Services Limited (SSL).

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 5 October 2001.
3. In its application, UEL sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's determination is based on an investigation conducted by staff.
5. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.¹

THE PARTIES

United Environmental Limited

6. UEL (trading as Nuplex Environmental) is a wholly owned subsidiary of Nuplex Industries Limited, a public company incorporated in New Zealand and listed on the New Zealand and Australian Stock exchanges. Nuplex is a supplier of virgin solvents², and is also a major customer of UEL in relation to the recycling of solvents.
7. UEL offers services in New Zealand for the identification, handling, collection/transportation, treatment, disposal and recycling/re-use of: waste liquids, sludges and solids, packaged and bulk materials, chemicals, oils, greases, solvents and simple organics.
8. Relevant to this application is UEL's involvement in, the provision of solvent disposal services, the provision of solvent recycling services, and the supply of recycled solvents. UEL has solvent refining plants in Auckland and Wellington.

Solvent Services Limited

9. SSL is a privately owned company that is also involved in the provision of solvent disposal services, the provision of solvent recycling services, and the supply of refined solvents. In addition, SSL is a supplier of virgin solvents.

¹ Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

² Virgin solvents are those which are not the product of the refining process but are new solvents.

10. SSL is a member of the Evergreen Environmental Group, a group of three companies engaged in the recovery and disposal of various industrial waste streams. The other companies in the group are Tallow Products Ltd and Chemwaste Industries Ltd.

OTHER RELEVANT PARTIES

Medi-Chem

11. Medi-Chem Waste Services Limited is a privately owned company based in Auckland, which is involved in chemical disposal, the distillation/recycling of solvents and flammables, hazardous storage and packaging, site remediation, medical and document disposal.

Chemwaste

12. Chemwaste Industries Limited is a privately owned company that operates waste treatment plants in Auckland, Wellington and Christchurch. Chemwaste is involved in the collection, treatment and disposal of industrial liquid and solid wastes. Chemwaste does not currently distil/refine solvents.

Tredi

13. Tredi New Zealand Limited is a subsidiary of Tredi S.A., a French owned group of companies involved internationally in the disposal of hazardous and intractable wastes. Tredi New Zealand manages the site clearance and transportation of wastes such as Polychlorinated Biphenyls (PCB's) to Tredi S.A.'s waste treatment sites in France. Tredi New Zealand recently commenced a joint venture with Auckland International Airport Limited, Waste Resources Limited. Waste Resources Limited operates an incinerator at Auckland International Airport for the disposal of hazardous material at Auckland International Airport.

Solvent Refiners

14. Solvent Refiners is based in Christchurch and predominately refines spent solvent sourced from the South Island.

Solvent Rescue

15. Solvent Rescue is also based in Christchurch and predominately refines spent solvent sourced from the South Island.

Solvent Recovery BOP

16. Solvent Recovery is a small operation based in Tauranga that sources its spent solvent from the Bay of Plenty and Waikato areas.

Anchor Products

17. Anchor Products ("AP") is a part of the New Zealand Dairy Group of Companies, which is soon to be a subsidiary of Fonterra Co-operative Group Ltd. AP extracts lipids from cream for use in infant formulas and cosmetics at its plant in Edgecumbe. In order to ensure that contaminants do not enter the process, AP uses virgin solvent in the process of extracting the lipids.

INDUSTRY BACKGROUND

Solvents

18. Solvents are liquids that have the ability to dissolve, suspend or extract other materials without chemical change to the material or solvent. Solvents are used in a number of industrial processes involving the application, cleaning, or separation of materials. Industries that commonly use solvents include: food processing, pharmaceutical manufacture, printing, painting and heavy industry.
19. In the food industry, solvents are used in the extraction of required substances from natural products, for example in the extraction of enzymes, oils, or flavourings. Similarly in the manufacture of pharmaceuticals, solvents separate the desired chemical products from unwanted ones, maximising the purity of the drug.
20. Solvents are used in paint manufacture to dissolve or disperse the different components (such as pigment and resin), and are also used to control the viscosity of paint. After paint has been applied, the solvent component evaporates, allowing the resin and pigment to produce a film of paint and to dry rapidly. In the printing industry, solvents are used to control viscosity and allow ink flow without damaging printing rollers. Solvents also ensure optimum drying of the ink, allowing presses to operate at higher speeds.
21. In addition, solvents are used to flush paint spray guns, wash down printing presses, and as a degreaser in the cleaning of automotive and industrial machinery parts. Once used, the contaminated or 'spent' solvents form part of a waste stream that may be recycled and used again in the same or other processes.
22. Users of solvents choose to recycle spent solvent for three main reasons:
 - ?? Economic – It is more cost effective to recycle solvent than to use more expensive virgin solvent;
 - ?? Waste Disposal – Use of solvents in industrial processes creates a hazardous waste stream which must be disposed of; and
 - ?? Environmental – Recycling reduces the amount of industrial waste to be disposed and therefore reduces associated environmental liability.
23. Industry participants interviewed advised that the market for refined solvents in New Zealand is diminishing due to the move offshore of manufacturing companies, together with a desire on the part of solvent users to find alternative processes that will reduce their use of solvents. That desire is largely driven by environmental factors.

Aqueous and Caustic-based Cleaners

24. Aqueous and caustic based cleaners are a biodegradable alternative to solvents in some industrial processes, in particular, parts degreasing. Parts degreasing has historically consisted of manually washing parts in a bath of solvent to rid them of grease. Advancements in technology together with a desire to have more environmentally friendly processes, has led some businesses to substitute their solvents for aqueous and caustic based cleaners.
25. Essentially, aqueous and caustic based cleaners are industrial-strength detergents that are typically used with custom-made parts washing machines. The process of dispersing 'detergent' over the greasy parts with jets of water and rotating the parts

resembles that which occurs in a domestic dishwasher. The waste from the process is usually released into a trade waste outlet.

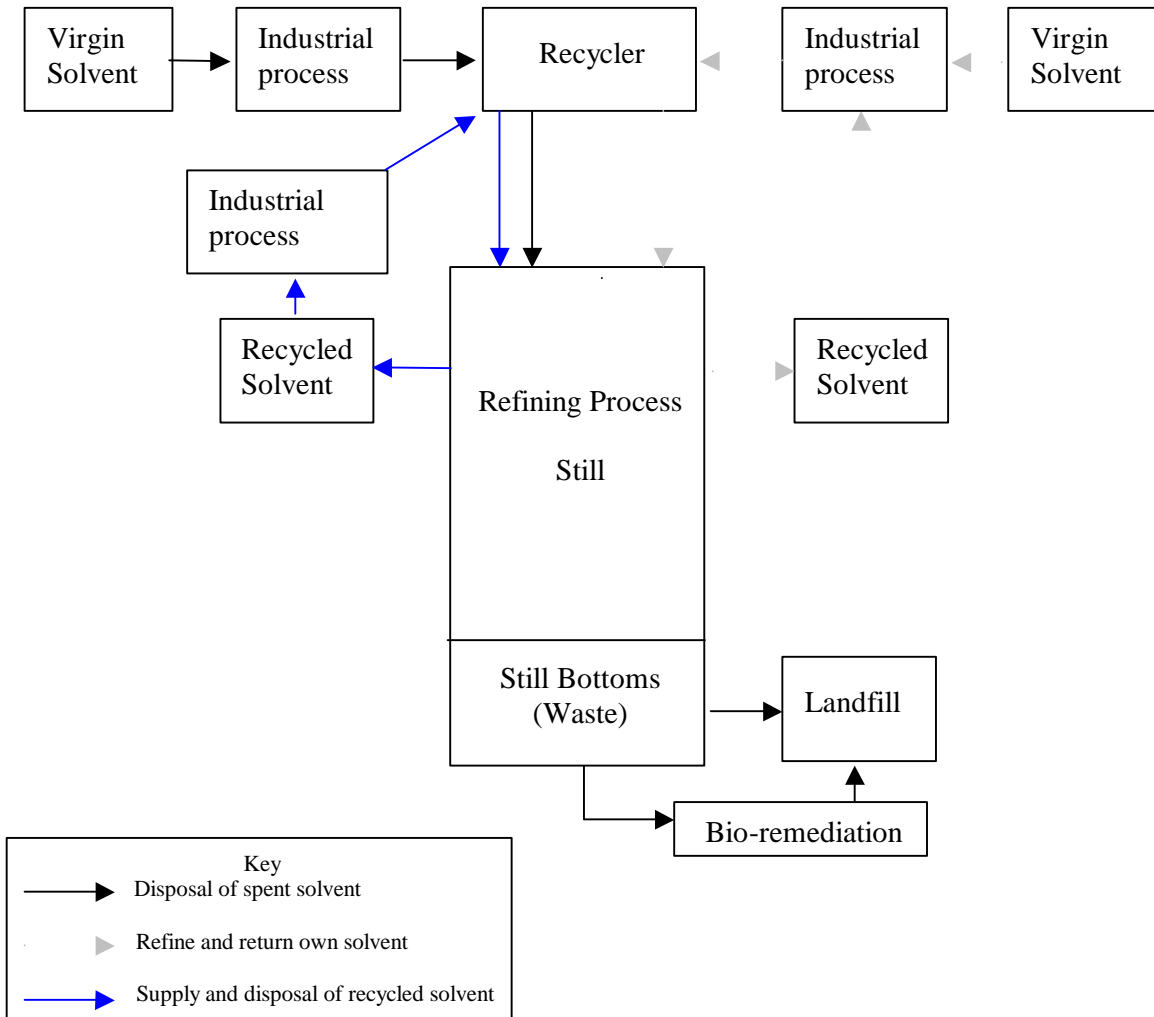
Legislation relevant to the Solvent Industry

26. Parties that recycle solvents are subject to the provisions of various legislation including the Resource Management Act 1993 (“RMA”) and the Hazardous Substances and New Organisms Act 2000 (“HSNO”). These Acts are enforced by various entities, including Regional Councils (Emission Consents - RMA), District and City Councils (Land Use Consents - RMA), and the Environmental Risk Management Authority (HSNO).
27. The Commission was advised by a Hazardous Waste Officer from the Auckland Regional Council (“ARC”), that the ARC’s regulations are probably more stringent than those of most other Regional Councils, as Auckland has very high density industrial areas and has therefore historically had a greater number of environmental impact issues.

Solvent Recycling

28. Solvent which has been used in a process is termed spent and may include substances such as paint thinners contaminated with paint sludge, degreasing solvent contaminated with oil, or printing solvent contaminated with ink. Often, the contaminants can be removed by a distillation process, which in some cases returns the solvent to near its original purity.
29. During distillation, spent solvent is heated, driving off the solvent in vapour form. The vapour reverts back to liquid form in a condenser and is collected, and the ‘still bottoms’, or waste remaining in the bottom of the still is then collected and disposed of.
30. Recycled solvents may be blended to produce lower grade solvent products such as ‘gun wash’, which is typically used to flush painting spray guns, particularly in the automotive spray painting industry, and ‘blanket wash’ used to flush ink from printing press blankets.
31. However, in some industries, such as food processing, recycled solvents cannot be used, as the solvent is not sufficiently pure to satisfy health standards. In these instances, the solvent user needs to dispose of the spent solvent rather than recycle it.
32. For some companies that choose to recycle their solvent for economic and environmental reasons, it is essential that their solvent is kept separate from others’ during the recycling process in order to prevent contaminants entering their solvent, and consequently, their processes. In this instance, the solvent recycling company either collects or receives the spent solvent; batch distils it, disposes of any waste, and returns the recovered solvent to the customer, rather than supplying the company with recycled solvent from general stocks. This is in essence, a tolling operation.
33. The usage, recycling and disposal of solvents is illustrated in Figure 1:

Figure 1
Usage, Recycling and Disposal of Solvents in the Solvent Recycling Industry



MARKET DEFINITION

34. The Act defines a **market** as:

... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.

35. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not

constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the ‘*ssnip* test’). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

36. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.
37. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:
 - ?? the goods or services supplied and purchased (the product dimension);
 - ?? the level in the production or distribution chain (the functional level);
 - ?? the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
 - ?? the temporal dimension of the market, if relevant (the timeframe).
38. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.
39. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

40. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers’ eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.
41. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.³ The

³ In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: “A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive”. See also *News Limited v Australian Rugby Football League Limited & Ors* (1996) ATPR at 41,687, where Burchett J stated: “Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation.” Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

42. The Applicant submitted that four markets will be affected by this acquisition:
- ?? The market for the transportation and disposal of solvent waste
 - ?? The market for the supply of solvents to businesses in New Zealand
 - ?? The market for the supply of virgin solvent
 - ?? The market for the supply of solvent recycling services to businesses in New Zealand

Demand-side substitution

43. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
44. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a snip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a snip would be profitable.
45. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.
46. Those companies that can only use virgin solvent in their processes must dispose of their spent solvent, as legislation precludes them from either disposing of it down trade waste traps or from stockpiling the solvent. Such companies generally pay solvent recyclers to take the spent solvent from their premises and dispose of it. Occasionally, when the recycling company is able to recover a solvent of high value from the waste stream, it may pay the customer for the spent solvent.
47. The Applicant submitted that the transportation of spent solvent is included in the disposal market. The Commission is of the view that, although it is convenient for a supplier of spent solvent to have the solvent collected and transported, the transportation of the spent solvent may be carried out by either the producer of the spent solvent or the recycler, and is therefore not relevant to the relevant market definition.
48. The Applicant claimed that those companies which recycle solvents for their own use (self-recyclers) should be included in the market for the provision of recycling services. Other industry participants disagreed. They explained that while the potential for a customer to commence self-recycling might offer some constraint on a merged entity,

those parties which currently self-recycle would offer no constraint, as they do not compete for business externally.

49. Moreover, some industry participants doubted whether a self-recycler would be able to gain the requisite resource consents, particularly in the Auckland region, to expand their recycling operations in order to produce recycled solvent for supply to external parties. Self-recyclers have usually commenced self-recycling in an effort to maintain quality and/or lower operating costs. Those self-recyclers interviewed said they would not enter the recycling market, as for them solvent recycling is a secondary process and not their core business.
50. The Commission is therefore of the view that the relevant markets do not include those parties that recycle solvent for their own use.
51. The Applicant claimed that virgin solvents and recycled solvents can be included in a general market for the supply of solvents, as for many businesses the two are substitutable. However, the Applicant also argued that there is a separate market for the supply of virgin solvents, the demand side of which is made up of businesses for whom recycled solvents are not substitutable for virgin solvents (such industries include: food and drinks, paint, resins, adhesives, pharmaceuticals, building products). In addition, the Applicant contended that aqueous and caustic based parts cleaners are also included in that market.
52. Industry participants said that while all users of recycled solvents could substitute virgin solvent for recycled product (albeit at a much higher price in some instances), for a significant number of solvent users, such as those listed above, compliance with quality standards necessitates that they use virgin solvents only.
53. Further, aqueous and caustic cleaners are substitutable for a relatively small segment of the market and for the majority of solvent users, could not be considered as substitutes.
54. The price differential between recycled and virgin solvents means that users of the former would not substitute the latter in the event of a snip being applied to recycled solvent. The Commission is of the view that the product markets for recycled solvent and virgin solvent are discrete, and that neither market includes aqueous and caustic based cleaners. As the proposed acquisition will not give rise to aggregation in the market for the supply of virgin solvent, this market will not be further discussed.

Supply-side substitution

55. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.
56. In terms of supply side substitution, there is arguably a market for the disposal of chemical waste. However compliance with legislation pertaining to the treatment of waste solvent can necessitate substantial investment in concreting, bunding⁴, and covered storage facilities. The Commission therefore considers it inappropriate to adopt the wider market in this instance.

⁴ Bunding, as used in the solvent recycling industry in New Zealand, is a raised concrete nib around the area in which drums of solvent are stored. It is designed to contain spillages and leaks from liquids, and to facilitate clean-up operations.

Undifferentiated/Differentiated Products

57. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.
58. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.
59. Some differentiation of product occurs in the market for the supply of recycled solvent. Whereas the dry cleaning industry mainly uses chlorinated solvents, the food processing industry might use acetone. The cost of such solvents also varies. However, the extent of differentiation is not such as to require close analysis of the extent of substitutability. For the purposes of this application, separate product markets for particular types of solvents, will not be defined.
60. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product markets are:
 - ?? The market for the provision of solvent disposal services;
 - ?? The market for the provision of solvent recycling services; and
 - ?? The market for the supply of recycled solvent.

Geographic Extent

61. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.
62. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.
63. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.
64. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

65. The Applicant submits that each of the markets it has defined is a national one as the transporting of spent or recycled solvent is relatively easy and inexpensive. Industry participants advised the Commission that they have transported solvents between the North and the South Islands for both sale and disposal. Further, they said that if the supply of spent solvent decreased in their geographical region, or if the demand for solvent disposal services, solvent recycling services or the supply of recycled solvent increased in another area, they would transport solvents between the North and South Islands. Accordingly, the Commission concurs with the Applicant that the geographic markets are national.

Functional Level

66. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.⁵ Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.
67. The Commission considers that in this instance, delineating functional levels of the relevant markets is not necessary for the purposes of competition analysis.

The Timeframe

68. Generally, the Commission will view markets as functioning continuously over time. However, where a market is characterised by, for example, infrequent transactions, the Commission may seek to define a separate time dimension as part of its market definition process. Time considerations are also important where there are long-term contracts, and where there are depletable resources.
69. Time dimension is not relevant to either the market for provision of solvent disposal services, the market for the provision of solvent recycling services, or the market for the supply of recycled solvents, as transactions in these markets are relatively frequent due to the ongoing processes of the companies requiring disposal and recycling services, and the recycled product.

Conclusion on Market Definition

70. The Commission concludes that the relevant markets are:
- ?? The national market for the provision of solvent disposal services (“the disposal market”);
 - ?? The national market for the provision of solvent recycling services (“the recycling services market”); and

⁵ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: “If we ask what functional divisions are appropriate in any market definition exercise, the answer, ..., must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market.”

?? The national market for the supply of recycled solvent (“the recycled market”).

COMPETITION ANALYSIS

Substantially Lessening Competition

71. Section 47 of the Act prohibits particular business acquisitions. It provides that:
- A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.
72. Section 2(1A) provides that substantial means “real or of substance”. Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.⁶ What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.⁷
73. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.⁸
74. While the Act defines the words “substantial” and “lessening” individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:
- ?? the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
 - ?? the nature and extent of the contemplated lessening; and
 - ?? whether the contemplated lessening is substantial.⁹
75. In interpreting the phrase “substantially lessening competition”, the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:
- Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.
- and, in relation to s47:
- This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).
76. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms

⁶ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

⁷ *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [] 1 All ER 289.

⁸ For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

⁹ See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

77. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

78. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

79. The Applicant submitted that:

[

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80. [

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81. [

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82. [The Commission proposes to use the status quo as the counterfactual¹⁰. If, following the competition analysis, the Commission were to conclude that the transaction would lead to substantial lessening of competition in a market then it may be appropriate to consider further the appropriate counterfactual.]

Potential Sources of Market Power

83. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between

¹⁰ The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed. *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

84. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one year time frame.¹¹ The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.
85. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a “chain of substitutes”, where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.
86. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.
87. The Commission considers that in the present application, the respective products and services are not so differentiated as either to cast doubt on there being single, well defined markets as described above, or to require a special analysis with fully differentiated product and service markets.

Conclusion – Competition Analysis Principles

88. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.
89. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity.

¹¹ See, for example, Roger D Blair and Amanda K Esquibel, “The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power” (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

The balance of this Decision considers and evaluates the constraints that might apply in the defined markets under the following headings:

- ?? existing competition;
- ?? potential competition from entry; and
- ?? other competition factors.

ANALYSIS OF EXISTING COMPETITION

Introduction

90. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

91. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.
92. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.¹²
93. In determining market shares, the Commission will take into account the existing participants (including ‘near entrants’), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission’s ‘safe harbours’, an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

¹² For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

The Market for the Provision of Solvent Disposal Services

Existing Participants

94. The existing suppliers in the disposal market are: UEL, SSL, Medi-Chem, Solvent Refiners, Solvent Rescue and Solvent Recovery BOP.

Inter-firm Relationships

95. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.
96. The Commission understands that there are no formal or other relationships between the participants in the disposal market.

Imports

97. In markets where imports are present, the Commission will consider whether actual competition from imported products is the equivalent to that from domestic supply. In undertaking this evaluation, the Commission will take into account the existence of any limits on quantities of imported product (the price elasticity of supply), and the effects on trade of various factors. Imports channelled through the parties to an acquisition, or persons associated with them, will be added to their domestic production in assessing market share, rather than being treated as independent sources of supply.
98. Potential imports may also provide a constraint on domestic suppliers. However, imports are not relevant to the disposal market.

Safe Harbours

99. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:
- ?? where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or
 - ?? where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.
100. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

Market Shares

101. Acquirers of solvent disposal services generally purchase the services according to the volume of solvent they wish to dispose of. In some cases, the solvent for disposal contains more hazardous waste, and the cost per litre for the disposal of such solvents is

therefore greater. Accordingly, the Commission proposes to use volume as its primary measure of market share and concentration. The resulting shares are shown in Table 1.

Table 1
Market Shares in the Disposal Market

Company	Volume in litres (000)	Market Share
UEL	[]	[]
SSL	[]	[]
Medi-Chem	[]	[]
Solvent Refiners	[]	[]
Solvent Rescue	[]	[]
Solvent Recovery BOP	[]	[]
Total	[]	100%

102. The data in Table 1 show the degree of market concentration. The three-firm concentration ratio is [] currently and would increase to [] post acquisition. The merged entity would have a market share of []. These percentages fall outside the Commission's safe harbours given above.

103. As noted above, market shares are insufficient in themselves to establish whether competition in a market has been lessened. The other competition factors noted above are considered in subsequent sections for the relevant market.

State of Existing Competition

104. The acquisition would result in the merged entity becoming the biggest provider of solvent disposal services with a market share of []. Despite this, the merged entity would face strong competition from other participants in the market.

105. [] has around [] market share, which post-merger would make it the second largest player in the market.

106. []

]

107. [] has around [] market share, making it the third largest player in the market post-merger. []

] if the merged entity raised prices by 10%.

108. Competition is therefore strong and increasing, with []

] These factors will increase the competitive constraint imposed on the combined entity.

Capacities

109. As well as market share based on volume, the Commission has also checked market share of the solvent recycling industry on the basis of capacity and excess capacity to ensure that the remaining players in the market can provide some constraint on the merged entity with regard to their ability to increase input and consequently output. These shares are shown in Table 2 and Table 3 below.
110. The figures contained in the tables are based on estimates provided by the market participants, and include []. It is recognised that the capacities are not precise, as capacity can be altered by increasing the number of hours the market participants operate their stills.

Table 2
Capacity of Participants in the Solvent Recycling Industry

Company	Capacity per annum (litres in 000)	Market Share
UEL	[]	[]
SSL	[]	[]
Medi-Chem	[]	[]
Solvent Refiners	[]	[]
Solvent Rescue	[]	[]
Solvent Recovery BOP	[]	[]
Total	[]	100%

111. Table 2 shows that a merged entity would have [] of the total industry capacity. [] has a significant amount of capacity, with [] of the industry total. The Commission understands that []
112. [] will have [] of the total capacity in the solvent recycling industry, which is also a significant share.
113. The ability of the market participants to impose effective constraint on the merged entity is dependent to a large extent on the amount of their total capacity which is available to satisfy any increased demand for their services, which may result from the merged entity increasing its prices significantly.
114. The excess capacity of the industry participants is shown in Table 3 below:

Table 3
Excess Capacity of Participants in the Solvent Recycling Industry

Company	Excess capacity per annum (litres in 000)	Share of excess capacity in the industry
UEL	[]	[]
SSL	[]	[]
Medi-Chem	[]	[]
Solvent Refiners	[]	[]
Solvent Rescue	[]	[]
Solvent Recovery BOP	[]	[]
Total	[]	100%

115. Table 3 indicates that the merged entity would have [] of the excess capacity in the industry, whereas [] has [] of the current industry capacity.
116. The excess capacity of current competitors in the solvent recycling industry, [] will impose considerable constraint on the merged entity.
117. The figures and comments relating to capacity and excess capacity for the disposal market also apply to the recycling services and the recycled markets.

Conclusions – Unilateral Market Power

118. The merged entity will be constrained by current competition. The [] and the excess capacity of [] will increase the competitive constraint imposed upon the combined entity.

Scope for the Exercise of Coordinated Market Power

Introduction

119. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.
120. In broad terms, successful coordination can be thought of as requiring two ingredients: ‘collusion’ and ‘discipline’. ‘Collusion’ involves the firms individually coming to a mutually profitable expectation or agreement over coordination; ‘discipline’ requires

that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

121. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

122. “Collusion” involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.
123. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column Table 4. The significance of these is explained more fully in the Commission’s *Practice Note 4*. The right-hand column of the table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the disposal market. A high proportion of ‘yes’ responses would suggest that the market was particularly favourable to ‘collusion’; a high proportion of ‘no’ responses the reverse.

TABLE 4
Testing the Potential for ‘Collusion’ in the Disposal Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes – The three firm concentration of [] is outside prescribed safe harbours.
Undifferentiated product/service	Yes – The service provided by industry participants is largely undifferentiated.
New entry slow	No – []
Lack of fringe competitors	No – There are several smaller fringe competitors with the ability to quickly increase their throughput.
Price inelastic demand curve	Uncertain
Industry’s poor competition record	No – No problems apparent.

Presence of excess capacity	Yes – There is significant amount of excess capacity in the market.
Presence of industry associations/fora	Yes – Some industry bodies but not all participants are members.

124. The assessment of the relevant structural and behavioural conditions in the disposal market in Table 4 suggests that the market has several characteristics that are likely to be conducive to collusion. The question is whether or not the likelihood of collusion is materially enhanced by the acquisition.
125. While several factors above are suggestive of the increased potential for collusion there are some factors that are not.
126. Although significant amounts of excess capacity exist, the merged entity has [] The majority of the excess is that of []. Both parties have advised the Commission that they would increase their throughput and compete more vigorously for the provision of disposal services, in the event of the merged entity raising prices by 10%.
127. In addition, the presence of smaller operators would make it difficult for the larger firms to collude because the incentive to “cheat” by smaller firms would be very high.
128. Not all participants in the disposal market are involved in industry associations, which lessens the likelihood of co-ordination between the parties. In addition, the industry meetings tend to be concerning industry regulation issues.
129. Overall there appear to be sufficient safeguards present in the market to ensure the proposed acquisition would not materially enhance the possibility of collusion.

Discipline

130. For co-ordination to be successful, deviations of individual firms from the collusive behaviour have to be discouraged by being detected swiftly and punished by the other firms.
131. The structural and behavioural factors that are usually considered to be conducive to ‘discipline’ in co-ordinated markets are set out in the left-hand column in Table 5. Again, the significance of these is explained more fully in the Commission’s *Practice Note 4*. The right-hand column of the table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the disposal market. A high proportion of ‘yes’ responses would suggest that the market was particularly favourable to ‘discipline; a high proportion of ‘no’ responses the reverse.

TABLE 5
Testing the Potential for “Discipline” in the Disposal Market

Factors conducive to discipline	Presence of factors in the market
High seller concentration	Yes – Three firm concentration ratio is outside prescribed safe harbours.
Sales small and frequent	Yes – Currently few long-term contracts.
Absence of vertical integration	Yes – Limited vertical integration.
Demand slow growing	Yes – Market is diminishing due to reduction in the use of solvents in New Zealand industry.
Firms have similar costs	Yes – Market participants were of the view that costs are proportionately similar but dependant on the scale of the operation.
Price transparency	Yes – Probably.

132. The assessment of the relevant structural and behavioural conditions in the disposal market in Table 5 suggests that the market is one where discipline could readily be maintained, should a collusive understanding or arrangement be attained. However, given that the Commission has concluded that collusion is unlikely to occur between the participants in this market, whether or not the participants could discipline one another in any co-ordination agreement becomes irrelevant.

Conclusions – Co-ordinated Market Power

133. The market contains some characteristics that tend to facilitate collusion. However there are additional factors present which are not conducive to collusion. On balance, it appears that it is unlikely that the proposed acquisition will materially enhance the likelihood of co-ordinated power.

Conclusions – Existing Competition

134. The Commission considers that existing competition will alleviate any concerns of unilateral power being exercised by the merged entity

135. Furthermore, the Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

136. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.
137. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.
138. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

139. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.
140. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.
141. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.
142. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.
143. Industry participants spoken to advised that the major requirements for a new entrant in the disposal market are:
- ?? resource consents and licences from the relevant authorities to store and process waste solvent;
 - ?? in most cases, a still to draw off solvent for reuse in an industrial process; and
 - ?? in most cases, access to a landfill in which to dispose of the waste stream from the distillation process.
144. Some industry participants said that the ARC appears to be more stringent in its application of the RMA than authorities in other areas, in relation to the disposal and recycling of solvents. However, the ARC advised the Commission that while it does have very particular requirements, it was possible to gain consents for such purposes. []
145. The ARC advised the Commission that some existing players in the market are currently experiencing difficulty with the renewal of their consents, as the parties no longer

complied with relevant legislation and regulations. However, the ARC advised that it would be relatively simple for a new entrant to gain consents if, for example, it were to set up in an existing warehouse which had concrete flooring in place.

146. Market participants in other areas of New Zealand advised the Commission that new entrants would have less difficulty entering the market if they based their operation in an area outside of Auckland. [

]

147. As spent solvent cannot be disposed of down trade waste traps or evaporated directly into the air, it is likely that a new entrant to this market would install a still to draw off reusable solvent and dispose of the still bottoms.

148. The Applicant contended that the cost of a still ranges from \$20,000 to \$500,000. While it is unlikely that a new entrant would start a competitive venture with a \$20,000 still, the Commission agrees with the Applicant's estimates. [

]

149. [

]

150. The operators of landfills are also subject to the provisions of the RMA. The Commission understands that so long as waste from the solvent distillation process complies with the dilutions required by these operators, access to a landfill should not be difficult in any area.

151. Although distillation is the usual way to dispose of spent solvent, it would be possible to use the spent solvent as a fuel to fire a furnace if the relevant Resource Consents were obtained. The Commission understands that a furnace which is currently gas-fired could be converted to run on spent solvent for [

The "LET" Test

152. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

153. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

154. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms

of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

155. [

]

156. [

]

Extent of Entry

157. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

158. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that “toe-hold” position may be difficult because of the presence of mobility barriers, which may hinder firm’s efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the ‘extent’ of entry.

159. Although resource consents may be necessary for expansion in this industry, some market participants have been able to do so. [

]

160. [

]

161. [

]

Timeliness of Entry

162. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

163. [

]

164. [

]

165. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers 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.

166. Although some contracts exist in the disposal market, they are not generally of a long-term nature. [

]

Conclusion on the LET Test

167. The Commission concludes that the various components of the LET test are satisfied.

Conclusion on Barriers to Entry

168. The Commission concludes that the barriers to entry are not likely to deter expansion or new entry in the disposal market. Potential competition is likely to provide constraint on the merged entity, and the solvent recycling industry as a whole.

OTHER COMPETITION FACTORS

Elimination of a Vigorous and Effective Competitor

169. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

170. The Commission does not consider SSL to be markedly different from any other firm in the industry. Given the other constraints listed above, SSL's removal from the market is unlikely to have a disproportionate effect on competition in the market.

Constraint from Buyers or Suppliers

171. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

172. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

173. The Applicant submitted that if the customers of the merged entity were dissatisfied with the services offered to them by the merged entity, the following options would be available to them:

?? undertake their own refining and transport the still bottoms directly to a landfill;

?? switch to other providers; and

?? switch to aqueous or caustic based substitutes (if applicable).

174. As previously mentioned, [

]

175. The ability of [] to self-supply in a relatively short time frame, suggests that some acquirers of disposal services could also self-supply if they became dissatisfied with the merged entity's service, and would therefore impose some constraint on the merged entity.

176. Given that there are relatively few long-term contracts in this market, the ability of acquirers of disposal services to switch service providers is relatively easy, especially with [] and the excess capacity of other players in the market.

177. As previously discussed, the Commission considers that aqueous and caustic based cleaners are not a viable substitute for the majority of parties using solvents, and as such, would offer little constraint on the merged entity.

178. The Commission is of the view that acquirers of solvent disposal services would impose some degree of constraint on the merged entity.

Efficiencies

179. The Commission recognises that there may be circumstances where efficiencies are relevant to an application for clearance.¹³ In the context of a business acquisition, the combined entity might be able to make efficiency gains that are not obtainable by other means, such that its unit cost of production would decline. This could result in the entity reducing its price below that obtaining prior to the acquisition, even though with the acquisition it would otherwise be considered to have substantially lessened competition, and would be able to raise price above costs.

180. Where the applicant can make a sound and credible case that such efficiencies will be realised, that they cannot be realised without the acquisition, and that they will enhance

¹³ In *Fisher & Paykel*, considered under s 27, the Court held that in assessing "substantial lessening of competition", a net approach to assessing anti-competitive effects was required: "The majority correctly accepted that it had to 'net out' the pro and anti-competitive effects and that, if it could be shown that the net effect of the EDC was to promote competition, then there could be no substantial lessening of competition." *Fisher & Paykel v Commerce Commission* [] 2 NZLR 731 at 740. See also: *Commerce Commission v Port Nelson*, supra n 6,433; *Shell (Petroleum Mining) Company Ltd v Kapuni Gas Contracts Ltd*, (1997) 7 TCLR 463, 531.

competition in the relevant market, the Commission will include them in the broader analysis of all of the competitive effects of the acquisition in the course of assessing whether or not competition is likely to be substantially lessened. However, the Commission envisages that efficiency claims of the required magnitude and credibility will only very rarely overturn a finding that competition would otherwise be substantially lessened.

181. While the Applicant has indicated that there are likely to be some synergy gains through the acquisition, the Applicant has not argued that efficiencies should be the basis for a clearance. The Commission does not consider that it is necessary to form a view on efficiency gains in the context of this application.

Conclusion on the National Market for the Provision of Solvent Disposal Services

182. The Commission has considered the probable nature and extent of competition that would that would exist in the disposal market but for the acquisition.
183. The proposed acquisition would result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines.
184. The Commission has considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:
- ?? existing competition;
 - ?? potential entry from competition; and
 - ?? other competition factors.
185. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the national market for the provision of solvent disposal services.

The National Market for the Provision of Recycling Services

Existing Participants

186. The existing suppliers in the recycling services market are: UEL, SSL, Medi-Chem, Solvent Refiners, and Solvent Rescue.

Market Share

187. Acquirers of solvent recycling services pay per litre of solvent that they have returned to them. Again, as some solvents for recycling contain more hazardous wastes, the cost per litre for their recycling is greater. The Commission therefore proposes to use volume as its primary measure of market share and concentration. The resulting shares are shown in Table 6.

Table 6
Market Shares in the Recycling Services Market

Company	Volume in litres (000)	Market Share
UEL	[]	[]
SSL	[]	[]
Medi-Chem	[]	[]
Solvent Refiners	[]	[]
Solvent Rescue	[]	[]
Total	[]	100%

188. The data in Table 6 show that the market is concentrated. The three-firm concentration ratio is [] currently and would increase to [] post acquisition. The merged entity would have a market share of []. These percentages fall well outside the Commission's safe harbours given above.

189. As noted above, market shares are insufficient in themselves to establish whether competition in a market has been lessened. The other competition factors noted above are considered in subsequent sections for the relevant market.

State of Existing Competition

190. The acquisition would result in the merged entity becoming the biggest provider of solvent recycling services with a market share of []. Despite this, the merged entity would face strong competition from other participants in the market.

191. [] has around [] market share, which post-merger would make it [] in the market. As previously mentioned, []

]

192. []

]

193. Competition is therefore present and increasing, with []

[] These factors will increase the competitive constraint imposed on the combined entity.

Conclusions – Unilateral Market Power

194. The merged entity will be constrained by current competition. The [] of the largest competitor will increase the competitive constraint imposed upon the combined entity.

SCOPE FOR THE EXERCISE OF COORDINATED MARKET POWER

Collusion

TABLE 7
Testing the Potential for ‘Collusion’ in the Recycling Services Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes – The three firm concentration of [] is outside prescribed safe harbours.
Undifferentiated product	Yes – The service provided by market participants is largely undifferentiated.
New entry slow	No – []
Lack of fringe competitors	No – There are several smaller fringe competitors with the ability to quickly increase their throughput.
Price inelastic demand curve	Uncertain
Industry’s poor competition record	No – No problems apparent.
Presence of excess capacity	Yes – There is a significant amount of excess capacity in the market.
Presence of industry associations/fora	Yes – Some industry bodies but not all participants are members.

195. Several factors in Table 7 are suggestive of the increased potential for collusion, however, the factors which are not are as set out for the disposal market above.

196. In addition, the Commission understands that [

] The Commission understands that there are no other formal or other relationships between the remaining participants in the three markets.

197. Given the possibility for new entry in particular, there appear to be sufficient safeguards present in the market to ensure the proposed acquisition would not materially enhance the possibility of collusion.

Discipline

TABLE 8
Testing the Potential for “Discipline” in the Recycling Services Market

Factors conducive to discipline	Presence of factors in the market
High seller concentration	Yes – Three firm concentration ratio is outside prescribed safe harbours.
Sales small and frequent	Yes – The ongoing nature of industrial processes ensures frequent transactions.
Absence of vertical integration	Yes – Limited vertical integration.
Demand slow growing	Yes – Market is diminishing due to reduction in the use of solvents in New Zealand industry.
Firms have similar costs	Yes – Market participants were of the view that costs are virtually identical amongst players.
Price transparency	Yes – probably. Participants seem to have gained pricing information from the clients of each other.

198. The data in Table 9 suggest that the recycling services market is one where discipline could readily be maintained, should a collusive understanding or arrangement be attained. However, given that the Commission has concluded that collusion is unlikely to occur between the participants in this market, whether or not the participants could discipline one another in any co-ordination agreement is irrelevant.

Conclusions – Co-ordinated Market Power

199. The market contains some characteristics that tend to facilitate collusion. However there are additional factors present which are not conducive to collusion. On balance, it appears that it is unlikely that the proposed acquisition will materially enhance the likelihood of co-ordinated power.

Conclusions – Existing Competition

200. The Commission considers that existing competition will be sufficient to constrain the merged entity.

201. Furthermore, the Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Barriers to Entry

202. Industry participants spoken to advised that the major requirements for a new entrant in the recycling services market are:

?? resource consents and licences from the relevant authorities to store and process waste solvent;

?? a still to draw off solvent for reuse in an industrial process; and

?? access to a landfill in which to dispose of the waste stream from the distillation process.

203. The discussion of these issues is as for those outlined in the disposal market above, although [

]

204. [

]

205. As was the case in the disposal market, stills can be readily obtained at prices ranging from \$20,000 to \$500,000.

206. [

]

The “LET” test

207. The factors relevant to the application of the LET test in the recycling market are the same as those in the disposal market, [

]

Conclusion on the LET Test

208. The Commission concludes that, as for the disposal market above, the various components of the LET test are satisfied in this market.

Conclusion on Barriers to Entry

209. The Commission concludes that the barriers to entry are not likely to deter expansion or new entry in the recycling services market. Potential competition is likely to provide constraint on the merged entity, and the solvent recycling industry as a whole.

OTHER COMPETITION FACTORS

210. The same considerations apply to the elimination of a vigorous and effective competitor, the constraint provided by buyers or suppliers, and efficiencies in the recycling services market, as in the discussion for the disposal market above.

Conclusion on the National Market for the Provision of Solvent Recycling Services

211. The Commission has considered the probable nature and extent of competition that would that would exist in the recycling market but for the acquisition.
212. The proposed acquisition would result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines.
213. The Commission has considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:
- ?? existing competition;
 - ?? potential entry from competition; and
 - ?? other competition factors.
214. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the national market for the provision of solvent recycling services.

The Market for the Supply of Recycled Solvent

Existing Participants

215. The existing suppliers in the recycled market are: UEL, SSL, Solvent Refiners, Solvent Rescue, and Solvent Recovery BOP.

Market Shares

216. Recycled solvent is supplied on a cost per litre basis. However, as there is a difference in price between various types of solvents, the Commission proposes to use volume as its primary measure of market share and concentration. The resulting shares are shown in Table 9.

Table 9
Market Shares in the Recycled Market

	Volume in litres (000)	Market Share
UEL	[]	[]
SSL	[]	[]
Solvent Refiners	[]	[]
Solvent Rescue	[]	[]
Solvent Recovery BOP	[]	[]
	[]	100%

217. The data in Table 9 show that the market is concentrated. The three-firm concentration ratio is [] currently and would increase to [] post acquisition. The merged entity

would have a market share of []. These percentages fall outside the Commission's safe harbours given above.

State of Existing Competition

218. The acquisition would result in the merged entity becoming the biggest provider of recycled solvent with a market share of [].
219. However, [] would have the second largest market share of [], followed by [] with []. Both parties indicated they would supply recycled solvent to the Auckland region if the merged entity raised prices by 10%.

Conclusions – Unilateral Market Power

220. The merged entity will be constrained by current competition. The relatively large market shares of other players in the market, combined with their excess capacity will impose a competitive constraint upon the combined entity.

SCOPE FOR THE EXERCISE OF COORDINATED MARKET POWER

Collusion

TABLE 10
Testing the Potential for 'Collusion' in the Recycled Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes – The three firm concentration of [] is outside prescribed safe harbours.
Undifferentiated product	Yes – The service provided by market participants is largely undifferentiated.
New entry slow	No – []
Lack of fringe competitors	No – There are several fringe competitors with the ability to quickly increase their throughput and [].
Price inelastic demand curve	Uncertain
Industry's poor competition record	No – No problems apparent.
Presence of excess capacity	Yes – There is a significant amount of excess capacity in the market.
Presence of industry associations/fora	Yes – Some industry bodies but not all participants are members.

221. Several factors in Table 10 are suggestive of the increased potential for collusion, however, the factors which are not are similar to those set out for the disposal market above.

222. Overall there appear to be sufficient safeguards present in the market to ensure the proposed acquisition would not materially enhance the possibility of collusion.

Discipline

TABLE 11
Testing the Potential for “Discipline” in the Recycled Market

Factors conducive to discipline	Presence of factors in the market
High seller concentration	Yes – Three firm concentration ratio is outside prescribed safe harbours.
Sales small and frequent	Yes – The ongoing nature of industrial processes ensures frequent transactions.
Absence of vertical integration	Yes – Limited vertical integration.
Demand slow growing	Yes – Market is diminishing due to reduction in the use of solvents in New Zealand industry.
Firms have similar costs	Yes – Market participants were of the view that costs are virtually identical amongst players.
Price transparency	Yes – probably. Participants seem to have gained pricing information from the clients of each other.

223. The data in Table 11 suggest that the recycled market is one where discipline could readily be maintained, should a collusive understanding or arrangement be attained. However, given that the Commission has concluded that collusion is unlikely to occur between the participants in this market, whether or not the participants could discipline one another in any co-ordination agreement is irrelevant.

Conclusions – Co-ordinated Market Power

224. The recycled market contains some characteristics that tend to facilitate collusion. However there are additional factors present which are not conducive to collusion. On balance, it appears that it is unlikely that the proposed acquisition will materially enhance the likelihood of co-ordinated power.

Conclusions – Existing Competition

225. The Commission considers that existing competition will alleviate any concerns of unilateral power being exercised by the merged entity.

226. Furthermore, the Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Barriers to Entry

227. Industry participants spoken to advised that the major requirements for a new entrant in the recycled market are:

- ?? a supply of spent solvent;
- ?? resource consents and licences from the relevant authorities to store and process waste solvent;
- ?? a still to draw off solvent for reuse in an industrial process; and
- ?? access to a landfill in which to dispose of the waste stream from the distillation process.

228. The discussion of these issues is as for those outlined in the recycling services market above. In addition, a new entrant to this market would need a supply of spent solvent to recycle. It is likely then that a new entrant would also enter the disposal market. As previously discussed, there is no shortage of spent solvent and a new entrant would have little difficulty securing a supply.

The “LET” test

229. The factors relevant to the application of the LET test in the recycled market are the same as those in the disposal market, []

Conclusion on the LET Test

230. The Commission concludes that, as for the disposal market above, the various components of the LET test are satisfied in this market.

Conclusion on Barriers to Entry

231. The Commission concludes that the barriers to entry are not likely to deter expansion or new entry in the recycled market. Potential competition is likely to provide constraint on the merged entity, and the solvent recycling industry as a whole.

OTHER COMPETITION FACTORS

232. Comments on the elimination of a vigorous and effective competitor, the constraint provided by buyers or suppliers, and efficiencies in the recycled market, are as those made in the discussion for the disposal market above.

Conclusion on the National Market for the Supply of Recycled Solvent

233. The Commission has considered the probable nature and extent of competition that would that would exist in the recycled market but for the acquisition.

234. The proposed acquisition would result in the merged entity obtaining a market share that falls outside the Commission’s safe harbour guidelines.

235. The Commission has considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

?? existing competition;

?? potential entry from competition; and

?? other competition factors.

236. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the national market for the supply of recycled solvent.

OVERALL CONCLUSION

237. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the following markets:

?? The national market for the provision of solvent disposal services;

?? The national market for the provision of solvent recycling services; and

?? The national market for the supply of recycled solvent.

DETERMINATION ON NOTICE OF CLEARANCE

238. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by United Environmental Limited of up to 100% of the assets of Solvent Services Limited which relate to:

- ?? The provision of solvent disposal services;
- ?? The provision of solvent recycling services; or
- ?? The supply of recycled solvent.

Dated this 5th day of October 2001

Paula Rebstock
Commissioner