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COMMERCE COMMISSION

Decision No. 456

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

SHELL NEW ZEALAND LIMITED

and

THE GAS COMPANY LIMITED

The Commission:

John Belgrave
Paula Rebstock
Donal Curtin

Summary of Application: The acquisition by Shell New Zealand Limited of up to 100% of the assets and interests associated with The Gas Company Limited.

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

Date of Determination: 1 March 2002

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THE PROPOSAL

1. On 4 February 2002 Shell New Zealand Limited (Shell) registered a notice with the Commission seeking clearance under s66 (1) of the Commerce Act 1986 to acquire up to 100% of the assets and interests associated with The Gas Company Limited (TGC).

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 1 March 2002.
3. In its application, Shell 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

Shell

6. Shell is part of the Royal Dutch/Shell Group of Companies. It ultimately has two parent companies:

    - Royal Dutch Petroleum Company, based in the Netherlands; and
    - The Shell Transport and Trading Company plc, based in the United Kingdom.

7. These two companies between them hold, directly or indirectly, all interests in the companies which comprise the Royal Dutch/Shell Group of Companies (the Shell Group). Shell Group companies are involved in activities relating to oil and natural gas, chemicals, electricity generation, and renewable resources in more than 135 countries.

8. Within New Zealand, the Shell Group is currently active in all the above areas. The primary activities of Shell NZ include:

- the exploration for, and production of, oil and gas, including holding significant shareholdings in the Maui and Kapuni fields;

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[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.

- the operation of *Shell* brand petrol stations, with more than 350 retail locations nation-wide;

- investments in renewable resources, most notably a joint venture with Carter Holt Harvey in Mangakahia Forest in Northland;

- the production and distribution of chemicals, including petrochemicals and detergents;

- the production and distribution of commercial products, including marine and aviation fuels, and lubricants; and

- equity investments in NZRC (17.1%), Fulton Hogan Limited (37.6%), Loyalty New Zealand Limited (25%) and the New Zealand Burger King franchise (50%).

9. Shell NZ owns 50% of the shares in Shell Todd Oil Services Limited (STOS). The remaining 50% of the shares are owned by Todd Energy Limited (Todd).

The Gas Company

10. Established in 1999, The Gas Company (TGC) is a privately owned re-seller of LPG servicing the greater Christchurch region.

11. The primary activities of TGC include:

    - re-filling of 22 kg and 45 kg LPG cylinders;
    - the supply of LPG to bulk tanks in the Christchurch region; and
    - retail of gas appliances from its Christchurch show room

Other LPG Companies

12. Several companies currently operate in the wholesale and/or retail market for LPG in New Zealand.

Air Liquide

13. Air Liquide specialises in the supply of industrial gases such as Carbon Dioxide, Argon, and Nitrogen. While LPG is not the core business of Air Liquide, it does supply LPG to its customers so that they can purchase their gas requirements from one supplier. [

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Rockgas

14. Rockgas has more than 50% of the LPG retail market in New Zealand. Established in 1934, Rockgas currently services 7,000 commercial accounts and over 13,000 domestic customers. Rockgas also distributes to over 30 automotive LPG refuelling outlets (Caltex, Mobil and Challenge). Rockgas is involved in LPG reticulation. In Christchurch Rockgas provides reticulated LPG to the CBD and to one residential

subdivision. Rockgas is also a wholesaler of natural gas and purchases its gas from Liquigas.

The Natural Gas Corporation of New Zealand (NGC)

15. NGC operates in all segments of the Christchurch LPG market, retailing gas through On Gas. Nationally, NGC is involved with gas transmission, gas distribution, gas wholesaling, electricity generation and energy retailing. NGC owns and operates gas treatment, processing and conditioning facilities at Kapuni and Taranaki, it sells LPG, natural gasoline and carbon dioxide. NGC holds long-term entitlements to gas supply, including approximately 27% of the reserves of the Maui field.

Todd Energy Limited (Todd)

16. Through its subsidiary, Todd Petroleum Mining Company, Todd has interests in Taranaki, and is a joint venture partner with Shell in the Kapuni field and in the Maui fields. Todd also own Otago Citigas, which supplies reticulated LPG in Dunedin and Otago.

BOC

17. BOC New Zealand is part of the global BOC group. BOC concentrate on the supply of industrial gases but also operate in the LPG market, much like Air Liquide, its direct competitor.

INDUSTRY BACKGROUND

18. LPG is essentially a by-product associated with the production of natural gas. LPG comprises either propane, butane or a mixture of the two. The physical properties of the two gases are such that alone, or as a mixture, they can be liquefied under moderate pressures and at normal temperatures. The following sections consider the various markets for LPG along its various stages.

Production

19. Production in New Zealand is dominated by the Maui field, opened in 1979. Its owners, Shell (87.5%) and Todd (12.5%) also own the older Kapuni field which supplies 15% of New Zealand's production.

20. There are 54 other companies that own rights to exploratory tracts around New Zealand. Smaller gas fields are owned by Bligh Oil and Minerals, New Zealand Oil and Gas Services and Ngataro Energy, but their production is not as significant.

Wholesale

21. Considerable gas (96 PJ in 2000) is sold direct from producers or the Crown to the petrochemical industry. 75 PJ is sold to electricity generators, and other users (mostly industrial) account for 57PJ. Around half the industrial load and most of the remaining load are purchased by retailers. Gas sellers include Shell, Todd, Contact, NGC and (potentially) the Crown. Emerging participants include Westech and Swift.

Retail

22. At the retail level, LPG is supplied by re-sellers such as TGC and service stations. Re-sellers typically supply LPG in cylinder sizes ranging from 5kg to 45 kg as well as in bulk tanks for larger commercial applications. In Christchurch some LPG is supplied via a reticulated supply to two subdivisions and to the CBD. Service stations only supply LPG for automotive purposes and in 9kg cylinders due to the practical and legal limitations of supplying LPG in large cylinders.

23. The LPG retail market in Christchurch is currently growing at a fast rate due to plans to end the use of heating methods such as coal and wood burning, in favour of cleaner heating such as LPG. This is increasing demand for both LPG and LPG appliances.

PREVIOUS DECISIONS RELATING TO LPG

24. Other relevant decisions are outlined here to illustrate how the Commission has considered markets within the LPG industry in the past.

Decision 411: Shell/FCE

25. In October 2000, Shell Exploration (Shell) sought clearance to purchase 100% of the shares of Fletcher Challenge Limited ("FCL") associated with its Energy Division (FCE"); and 100% of the shares in Zurich Holdings (No. 7) Limited ("Zurich"), being the holding company for FCE. This included an undertaking to divest the following assets:

- 10% equity interest in the Maui field;
- all of FCE's interests in the Kupe field;
- all of FCE's interests and involvement in Fletcher Challenge Gas Investments Limited;
- all of FCE's interests in the Ngatoro field;
- all of FCE's interests in the McKee field;
- interests in the Pohokura field;
- all of FCE's interests in the Kaimiro field (excluding potential deeper reservoirs); and
- all of FCE's direct and indirect interests in the in the Mangahewa field.

26. In this case the Commission considered the current gas production market, the post 2009 gas production market, and the LPG production market. The Commission concluded that the acquisition would not likely result in dominance in any market.

Decision 323: Rockgas/ Energy Supply Limited

27. Rockgas, an LPG supplier and retailer, sought clearance to purchase Energy Supply Limited, an LPG re-seller based in Lower Hutt.

28. The Commission considered the LPG product, wholesale and retail markets and found that the aggregation resulting from the acquisition did not raise competition concerns. The Commission considered that Rockgas faced significant competition from Shell and BP. Clearance was given for the acquisition in April 1998.

MARKET DEFINITION

29. 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.*

30. 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.

31. 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.

32. 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).

33. 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.

34. 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.

35. The applicant submitted that the market that will be affected by the proposed acquisition is the retail market for LPG in the greater Christchurch city area.

Product Dimension

36. 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.

37. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[2] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see above) 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.

Demand-side and Supply-side substitution

38. 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.

39. 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 ssnip 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 ssnip would be profitable.

40. 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.

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[2] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 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.

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.

41. 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.

42. LPG is a by-product of natural gas production, and the quantity of LPG produced is dependent on the level of natural gas production. However, the Commission has previously considered that there is a separate product market for LPG. In Decision 323[3], the Commission noted that on the supply-side, the limited possibility for supply-side substitution appears to indicate that LPG may form its own product market, rather than being part of a wider energy market.

43. On the demand-side, there is a wide variation in the degree to which different consumers can substitute different fuel types. Some applications are dependent on LPG, particularly in the absence of natural gas as an alternative fuel. In other applications, LPG offers significant advantages which limit the cost-effectiveness of substituting a different fuel type.

44. The Commission considers that while different energy forms provide some competition to each other, they should not be included in the same market. While other forms of energy are substitutable for LPG to a degree, investments in LPG equipment by LPG consumers mean that there is only a limited degree of demand side substitutability.

45. Industry participants noted that electricity prices in particular place a constraint on the price of LPG at the retail level. Electricity was not, however, considered to be a substitute to LPG. Industry participants noted that they considered the market for LPG to be separate from the market for other energy types and did not consider the energy market to be a single market.

46. Industry participants noted a trend towards segmentation of the market, with demand for propane or mixes high in propane increasing. Propane is marketed as a premium product, particularly in cold areas, where it is more suitable because of its lower boiling point. At temperatures below zero, butane will not vaporise and will remain in the cylinder as a liquid, while the propane is all used. However, despite this, none of the industry participants spoken to by Commission staff suggested that the product market should be defined more narrowly than that for LPG.

47. Supply side substitutability in industry is very low. The supply of LPG is a specialised activity and it would be difficult for a supplier of LPG to move to supplying another form of energy.

48. The type of cylinder used to supply LPG also has an impact on demand and supply side substitution. Re-sellers typically supply LPG in a variety of cylinder sizes, ranging from 5 kg to 45 kg. Due to practical and legal limitations, service stations cannot supply LPG in cylinders larger than 9 kg. On the demand side, smaller cylinders cannot be

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[3] Decision 323, *Rockgas Ltd and Energy Supply Ltd*, 24 April 1998.

considered substitutable for larger cylinders as they have different applications. Smaller cylinders, for example, have primarily domestic applications, such as home heating, while larger cylinders are typically employed for large-scale domestic and commercial use.

49. LPG is also supplied in bulk via tanker to large tanks and via reticulated pipes to some subdivisions and to the CBD and arterial routes in Christchurch. This supply can be considered substitutable for other supplies of LPG only for customers that can access the network.

50. Despite the differences between cylinder types and sizes, the Commission considers that the common element, namely LPG, means these do not constitute separate markets. However, given the differentiation of sizes and their different applications, the Commission considers the 5 and 9kg cylinders are in a different segment of the LPG market from the 22 kg, 45 kg, bulk tank, and reticulated supply.

51. The Commission concludes that, for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product market is LPG.

Geographic Extent

52. 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.

53. 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.

54. 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.

55. 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.

56. The applicant submitted that the likely geographic market for the proposed acquisition is the greater Christchurch city area.

57. From the supply perspective, LPG must be stored near or close to its customers for cost effective and timely supply. Due to the height, weight, and volume characteristics of

LPG cylinders relative to their value, suppliers are not able to supply customers that are long distances from their filling depots.

58. From the demand perspective, customers are unlikely to travel great distances to purchase LPG. Consumers of relatively small quantities might be persuaded to travel across town for a better price, however, they are unlikely to travel outside of Christchurch.

59. The Commission concludes that the geographic market is a *regional* one, and has defined the geographic dimension as the Christchurch region for this application.

Functional Level

60. The production, distribution and sale of a product typically occur 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.[4] 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.

61. TGC is a re-seller of LPG, it purchases LPG from a wholesaler and re-sells it to the market. For the purpose of analysis for this acquisition, the functional level is considered to be the retailing of LPG.

Conclusion on Market Definition

62. The Commission concludes that the relevant market is the retail market for LPG in the Christchurch region.

COMPETITION ANALYSIS

Substantially Lessening Competition

63. 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.

64. 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.[5]

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[4] *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."

[5] *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).

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.[6]

65. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[7]

66. 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.[8]

67. 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)."*

68. 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 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.

69. 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

70. The Commission uses a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that

[6] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [1993] 1 All ER 289.

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

[8] 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.

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.

71. If Shell was not to acquire TGC, it is possible that it would be purchased by another major oil company. [

]. However, given that TGC is trading profitably, it is not inevitable that it will be sold.

72. 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 an acquisition not occur[9]. The Commission considers that the status quo is the most appropriate counterfactual given the uncertainty of what changes, if any, there will be in the market if the proposed acquisition does not proceed. The Commission therefore proposes to use the status quo, that is the independent ownership of the Gas Company, as the counterfactual.

Competition Analysis Principles

73. 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.

74. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints that might apply in the defined markets under the following headings:

- existing competition; and
- potential competition from entry.

ANALYSIS OF EXISTING COMPETITION

Introduction

75. 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.

[9] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 &114.

Scope for Unilateral Market Power

Introduction

76. 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.

77. 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 that 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 that lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[10]

78. 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.

Existing Participants

79. There are currently four retailers of natural gas in the Christchurch region. These include Rockgas, On Energy, BOC Gas, and TGC as outlined in Table One below. As well as these four re-sellers, Caltex, Challenge, Mobil, and BP operate competing service stations with LPG tanks in the Christchurch city area. These sites compete with the Shell brand service stations in the 9 kg cylinder market segment of the LPG retail market.

Inter-firm Relationships

80. 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.

81. Shell currently supplies three out of the four re-sellers of LPG (BOC Gas, On Energy, and TGC) as well as its own service stations, leading it to supply [ ] of the gas in the Christchurch LPG retail market. However, the Commission does not consider that this makes Shell associated with these re-sellers.

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[10] 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.

Safe Harbours

82. 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%.

83. 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.

Table One Market Share Figures

	Retailer and Owner	Wholesale Supplier	Volume tpa	Market Share (%)
Resellers	Rockgas (*Caltex 50% Origin 50%)*	Rockgas	[ ]	[ ]
	On – Energy *(NGC)*	Shell	[ ]	[ ]
	BOC Gas	Shell	[ ]	[ ]
	TGC	Shell	[ ]	[ ]
Sevice Stations	Shell	Shell	[ ]	[ ]
	BP	NGC	[ ]	[ ]
	Caltex	Rockgas	[ ]	[ ]
	Mobil	Rockgas	[ ]	[ ]
	Challenge! (*Caltex)*	Rockgas	[ ]	[ ]
Total			**[ ]**	**100**

84. The proposed acquisition will result in the merged entity increasing its market share from [ ]. The concentration ratio of the three largest firms will be [ ]. The proposed acquisition would, therefore, result in a market that falls outside the Commission's safe harbours.

85. Shell already has a presence in LPG retail in Christchurch through its Shell service stations where it sells LPG in the 9kg cylinder segment of the market only. The Gas Company do not sell LPG in 9kg cylinders. These factors, combined with the [ ] market share of the gas company, mean there is little aggregation in the Christchurch LPG retail market.

S*tate of Existing Competition*

86. All industry participants spoken to advise that the retail market for LPG is competitive and that this competition is unlikely to be affected by the proposed acquisition. Strong growth in the Christchurch LPG retail market is helping to promote additional competition. The Commission has previously found (decision 310) the LPG wholesale market to be competitive.

87. Amongst re-sellers, Shell would face competition from three others. Rockgas appear to be the strong competitor and has a higher market share. However, it faces competition from the three other oil companies who all have a relatively well established presence in the market.

Conclusion – Unilateral Market Power

88. Shell will not gain unilateral market power by purchasing TGC.

Scope for the Exercise of Coordinated Market Power

Introduction

89. 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.

90. 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.

91. "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.

92. 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 exploration 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 Retail Market for LPG in Christchurch

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Moderate
Undifferentiated product/service	Some differentiation by cylinder size
New entry slow	No
Lack of fringe competitors	No
Price inelastic demand curve	No
Industry's poor competition record	No – no problems apparent
Presence of excess capacity	No
Presence of industry associations/fora	Yes – Some industry bodies

93. The assessment of the relevant conditions suggests that the market has few characteristics that are likely to be conducive to collusion.

Conclusion – Co-ordinated Market Power

94. It appears unlikely that the proposed acquisition would materially enhance the likelihood of co-ordinated market power in the gas exploration market.

Conclusion – Existing Competition

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

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

VERTICAL INTEGRATION

97. The above analysis considers the horizontal aggregation at the retail level, vertical integration occurs as a result of Shell's presence in the wholesale market and the acquisition of TGC strengthening it's role in the retail sector.

98. In assessing vertical acquisitions, the Commission's main concern will be where a position of substantial market power in one market is likely to be strengthened or leveraged into another market. The Commission's Practice Note 4 states that: [11]

> "in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless a situation of a substantial degree of market power exists at one of the functional levels affected by a vertical acquisition. Where such a situation is found to exist, the Commission will examine the acquisition to determine whether that

[11] Practice Note 4, Page 44.

> position is likely to be strengthened or extended to other markets, and whether that will substantially lessen competition."

99. Shell cannot be said to have substantial market power in either of the markets relevant to the current application. It faces competition at the wholesale level from NGC and Rockgas, and at the retail level from Rockgas and the other oil companies. Furthermore, Shell is already the supplier of TGC, and it is assumed this will continue under the counterfactual. Therefore, the acquisition does not represent any change in the vertical relationships within the market.

100. The Commission, therefore, concludes that there is no likelihood of a substantial lessening of competition as a result of vertical integration associated with the acquisition.

OTHER COMPETITION FACTORS

101. The constraint from existing competition is sufficient to satisfy the Commission that the proposed merger would not have, nor would likely have, the effect of substantially lessening competition in the retail market for LPG in Christchurch. It is therefore unnecessary in this case to discuss in detail the issue of potential competition and other competition factors.

OVERALL CONCLUSION

102. The Commission has considered the probable nature and extent of competition that would exist in the exploration market but for the acquisition. The Commission considers that the appropriate benchmark is the status quo, in which the market is characterised by effective competition from existing participants.

103. 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.

104. 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 Christchurch retail market for LPG.

DETERMINATION ON NOTICE OF CLEARANCE

105. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Shell New Zealand Limited of up to 100% of the assets and interests associated with the Gas Company.

Dated this 1st Day of March 2002

John Belgrave