



COMMERCE COMMISSION

Decision No. 645

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

Redeal Limited

and

Egley Electrical Co Limited and Egley Electrical Petone Limited

The Commission: Peter J M Taylor
Denese Bates QC
Donal Curtin

Summary of Application: Redeal Limited, or any of its interconnected bodies corporate, has applied for clearance to acquire 100% of the assets and business of Egley Electrical Co Limited and Egley Electrical Petone Limited in Wellington.

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: 12 June 2008

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EXECUTIVE SUMMARY

- E1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 16 May 2008. The notice sought clearance for Redeal Limited (the Applicant or Redeal), or any of its interconnected bodies corporate, of 100% of the assets and business of Egley Electrical Co Limited and Egley Electrical Petone Limited (together Egley) in Wellington. The Applicant considered the proposed acquisition would result in horizontal aggregation in respect of the supply of electrical products in the Wellington/Wairarapa region.
- E2. For the purpose of considering this Application, the Commission concludes that the relevant market is that for the wholesale supply of electrical and related products in the Greater Wellington region (the 'Wellington electrical products' market).
- E3. The Commission considers that the likely counterfactual scenario (without the acquisition) would be as follows:
- Redeal would continue to be active in the relevant market;
 - Egley would either continue to operate in the relevant market or be acquired by another party;
 - J A Russell is likely to enter the relevant market;
 - Advance and Crane would continue to be strong competitors in the relevant market; and
 - Stewarts and Stemco would be smaller competitors in the relevant market.
- E4. In the factual scenario (with the acquisition) the Commission considers that:
- the merged entity, Advance, Crane, Stewarts and Stemco would compete in the relevant market; and
 - J A Russell is likely to enter the relevant market.
- E5. The Commission concludes that it is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the Wellington electrical products market. The Commission considers that, in the factual, the merged entity is likely to face constraints in this market from:
- existing competition from Advance and Crane;
 - the threat of new entry; and
 - the countervailing power of customers.
- E6. As a result, while there is some aggregation of market shares, the resulting lessening of competition in the factual is unlikely to be substantial in comparison with the counterfactual.
- E7. The Commission determines to give clearance to the proposed acquisition.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 16 May 2008. The notice (the Application) sought clearance for the acquisition by Redeal Limited (Redeal or the Applicant), or any of its interconnected bodies corporate, of 100% of the assets and business of Egley Electrical Co Limited and Egley Electrical Petone Limited (together Egley) in Wellington. The Applicant considered the proposed acquisition would result in horizontal aggregation in respect of the supply of electrical products in the Wellington/Wairarapa region.

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to give clearance or to decline to give clearance, to the acquisition referred to in a s 66(1) notice, within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 20 June 2008.
3. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's *Mergers and Acquisitions Guidelines*.¹

STATUTORY FRAMEWORK

4. Under s 66 of the Act, the Commission is required to consider whether the proposal will have, or would be likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal would not be likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline the application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
5. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held:

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³
6. In determining whether there is a change along the spectrum which is significant, the Commission must identify a real lessening of competition that is more than

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-721.

³ *Air New Zealand & Qantas Airways Limited v Commerce Commission* (2004) 11 TCLR 347, Para 42.

nominal and not minimal.⁴ Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

7. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.
8. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

9. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
 - with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).
10. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual, in terms of:
 - existing competition;
 - potential competition; and
 - other factors, such as the countervailing market power of buyers and the ability of suppliers to co-ordinate their pricing in the market.

THE PARTIES

Redeal Limited

11. Redeal is a wholly-owned subsidiary of the Rexel Group, a large international distributor of electrical installation products which is based in France. Redeal is involved in the following activities:

⁴ *Fisher & Paykel Limited v Commerce Commission* (1990) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 563.

- the wholesale supply of a wide range of electrical products from its Ideal and Rexel outlets. It currently operates 78 branches nationwide, of which six are located in the Greater Wellington region;⁵ and
- the importation and distribution of lighting products through its Impel business.

Egley Electrical Co Limited/Egley Electrical Petone Limited

12. Egley is a privately-owned company which is involved as a wholesaler of a wide range of electrical products from two branches in Greater Wellington, one in Wellington City and the other in Petone.
13. Egley is currently a member of the Powerbase Incorporated Society (Powerbase), which is a group of independent electrical product wholesalers with outlets throughout New Zealand.⁶

Other Relevant Parties

14. Crane Distribution NZ Limited is involved in the wholesaling of a wide range of electrical products through its Corys Electrical and MasterTrade divisions. It operates a total of 8 branches in Greater Wellington, two under the Corys Electrical brand and the balance under the MasterTrade brand.
15. As noted above, Powerbase is a group of independent electrical product wholesalers. Aside from Egley, other existing participants in Powerbase include:
 - Advance Electrical Wholesalers Limited, and related companies (together Advance). These companies are involved in the wholesaling of a wide range of electrical products from five branches in Greater Wellington;
 - Andrew Stewart & Sons Limited (trading as Stewarts Electrical Supplies (Stewarts)), which operates 10 branches in the lower North Island, including one branch in Greater Wellington (Paraparaumu); and
 - J A Russell Limited, which has 53 branches in the North and South Islands (but no existing involvement in Greater Wellington).
16. Powerbase was formed in order for group members to take advantage of the increased marketing, product sourcing and purchasing ability that collective action afforded them. However, the Commission has been advised by industry participants that the individual members compete strongly with each other in the localities where two or more Powerbase members operate. For example, in the Greater Wellington region, the Commission was advised by electrical contractors and wholesalers that there is strong competition between Advance and Egley.⁷ The Chairman of Powerbase told the Commission that Powerbase members are also free to negotiate separate purchasing arrangements with suppliers, set their own

⁵ For the purpose of this report Greater Wellington includes Wellington city, the Hutt Valley, and the Porirua region extending as far as Paraparaumu.

⁶ See paragraph 16 below for further background information relating to Powerbase. Redeal advises that [

]

⁷ See paras 22 and 23 for a further discussion on how the Commission proposes to consider Powerbase and its members when analysing this Application.

pricing and trading terms, and to undertake their own marketing and promotional activities.

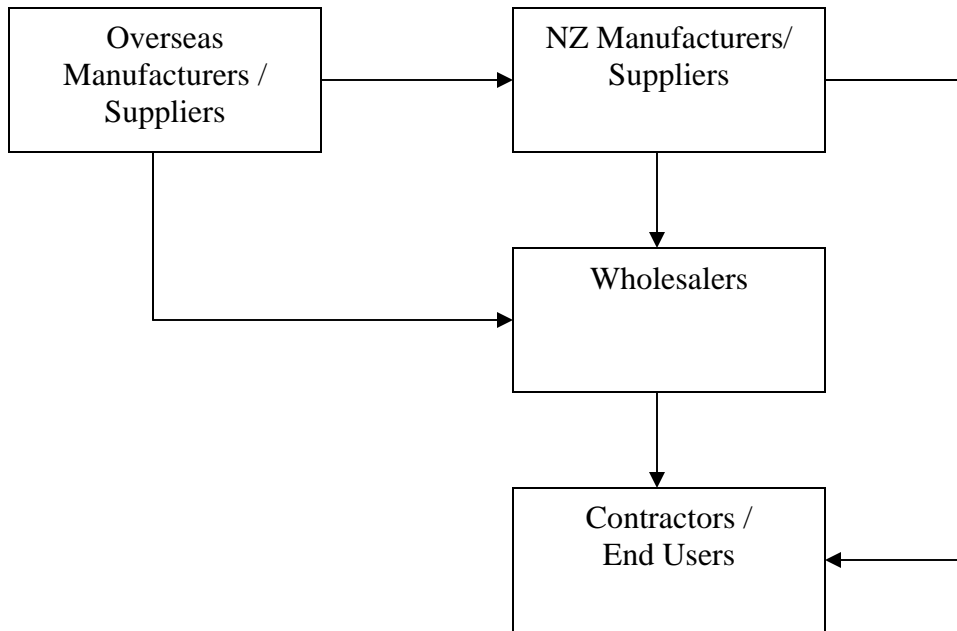
17. In addition to the parties mentioned above, there are:
- many importers/manufacturers of electrical products, including Philips, Thorn and Pierlite (lighting); Schneider Electric and HPM (plastics); and General Cable, Prysmian and Olex (cables). These companies supply to electrical wholesalers and direct to other customers, which may include building merchants and specialist retailers; and
 - numerous electrical contractors who comprise large scale users of electrical products, and the major customers of electrical wholesalers.

Previous Commission Decision

18. The Commission has previously considered the supply of electrical products in *Decision 444: Mico Wakefield Limited / Mastertrade Limited*, 6 December 2001. In that decision, the Commission defined regional markets for the supply of electrical products. The Commission concluded that existing competition would be sufficient to constrain the merged entity and that there were no barriers to entry likely to deter expansion or new entry into the relevant markets. The Commission determined to give clearance to this acquisition.

INDUSTRY BACKGROUND

19. This Application involves the wholesaling of a wide range of electrical and related products. Generally speaking, manufacturers and importers of such products supply to electrical wholesalers, retailers including the merchant chains (e.g. Placemakers) and specialist retailers, and in some circumstances, directly to large electrical contractors.
20. There are three major groups of electrical wholesalers in New Zealand: Redeal, various Powerbase members and Crane. These wholesalers offer a wide range of products for sale to their customers. Electrical contractors and corporate clients employing their own electricians, account for most of the sales of these wholesalers with a much smaller portion of sales (usually around []%) made to end user customers.
21. Diagram 1 outlines the structure of the industry and the different functional levels.

Diagram 1 – Electrical Products Industry and Functional Levels**Inter-Firm Relationship**

22. As noted previously, Powerbase is a group of independent electrical products wholesalers that acts as a joint marketing and buying organisation on behalf of its members. There are no ownership links between the members of the group, although several wholesalers spoken to claimed that there is a strategic partnership between J A Russell and Stewarts. J A Russell advised that the relationship between the companies is confined to using a common software programme.
23. The Commission has been advised by electrical contractors and by electrical wholesalers that where two or more Powerbase members operate in the same locality they compete strongly with each other, including on price and non-price considerations. This applies in the Greater Wellington region between Advance and Egley, with each company viewing the other as its principal competition, and offering different pricing structures. Taking these factors into consideration, the Commission proposes for the purpose of the analysis to treat each member of the Powerbase group as a discrete entity.

MARKET DEFINITION

24. In considering this Application the Commission must identify the relevant markets in which competition would be impacted by the proposed acquisition.

25. In Decision 444, the Applicant submitted, and industry participants confirmed, that electrical products covered a diverse range of products. These included:
- cables;
 - cable/protection and repair;
 - data and communications, TV and repair;
 - switchgear;
 - lighting;
 - distribution (fuses, timers, meter boxes, transformers etc);
 - industrial and motor control (sensing and detection, motors, capacitors, starters, indicators/lamps etc);
 - hot water systems and appliances; and
 - hardware (tools, safety and fire-fighting products, fasteners, consumables, heaters, connectors, leads/power boards etc).
26. In addition to the products outlined above, Redeal has submitted that power poles/lampposts; air conditioning; and security systems are also electrical products, and therefore should be included in the above list.
27. In Decision 444, the Commission noted that many of the products identified above are not substitutable from a demand-side perspective, as their form and function are specific for the purpose to which they are put. However, for the purpose of simplifying the analysis, the Commission adopted a generic 'electrical products' market.
28. Industry participants spoken to have confirmed the Commission's view that the product dimension of the market incorporates the items listed in Decision 444, and the additions proposed by the Applicant. Further, enquiries revealed that there is a high level of substitution on the supply side with wholesalers being able to readily switch or expand into different electrical product lines, if demand warrants it. Accordingly, the Commission proposes to adopt a single electrical products market for the purpose of analysing the competitive impact of the proposed acquisition.
29. In Decision 444, the Commission noted that the functional dimension of the market was blurred, given that the merger participants supply electrical products to tradespeople at the wholesale level and resell at the retail level. However, in considering this Application, the Commission has been advised by electrical wholesalers that most sales are made to trade customers, with only a small percentage of business to end user customers. For example, Redeal estimates that only [] of its sales in the Wellington area are made to end user customers, with the balance of sales being made to the trade. In view of these factors, the Commission proposes to adopt a functional level of wholesale supply for the purpose of analysing the proposed acquisition.
30. When considering the geographic boundaries of the electrical products market in Decision 444, the Commission agreed with the Applicant that the geographic

markets were regional in scope. Accordingly, the Commission adopted 12 separate regional markets as proposed by the Applicant. This included the Wellington/Wairarapa market. Redeal considers the Wellington/Wairarapa region is appropriate for the purposes of the proposed acquisition on the basis that it has a branch itself in Masterton trading under the Ideal banner. Also, consistent with Decision 444, Redeal submits that the majority of sales are made by tradespeople who, by the nature of their work, cover a number of different localities.

31. However, in considering the proposed acquisition, the Commission notes that Egley itself only operates from branches in Wellington and Petone, and while it conducts business in the Wairarapa, the level of sales is very small. Further, the Commission has been advised that electrical contractors often prefer to deal with branches in their immediate locality for convenience and other service reasons. Accordingly, for these reasons, and given that the aggregation of market share that would result from this acquisition would occur primarily in the Greater Wellington area, the Commission considers that region represents the appropriate geographic market for the purpose of considering this acquisition.
32. In summary, the Commission concludes that the relevant market for the purpose of assessing the proposed acquisition is the Greater Wellington market for the wholesale supply of electrical products (the 'Wellington electrical products market').

FACTUAL AND COUNTERFACTUAL

The Factual

33. When assessing the competitive impacts of a merger, the Commission compares the likely situation with the merger (the factual) with the likely situation without the merger (the counterfactual).
34. In the factual, Redeal would acquire the assets and business of Egley. Redeal advised the Commission that it []
35. The proposed acquisition would result in the aggregation of two of the four largest market participants. The other remaining competitors in the factual would be Advance and Crane. Stewarts and Stemco would also remain as smaller competing suppliers.
36. [] wholesalers spoken to anticipate that J A Russell is highly likely to enter the Wellington region. []
37. [] the Commission considers that J A Russell is a likely entrant into the relevant market in both the factual and

counterfactual. It notes that J A Russell has been expanding its operations over recent years, including into the South Island (and Australia), mainly by acquisition of other Powerbase member companies. Currently, J A Russell has 53 branches, of which 17 are located in the South Island. The only geographic region in which it does not have an existing presence is the lower North Island.

The Counterfactual

38. The Commission considers that in the counterfactual:
- Redeal would continue to be active in the relevant market;
 - Egley would either be acquired by another party, or continue operating in the relevant market. []
 - J A Russell is likely to enter the relevant market;
 - Advance and Crane would remain as competitors in the relevant market; and
 - Stewarts and Stemco would continue as smaller competitors in the relevant market.

COMPETITION ANALYSIS

Unilateral Effects

Overview

39. The Commission has been informed by many industry participants that the Wellington electrical products market is already characterised by intense competition, and that that the market situation is unlikely to change significantly in the factual.

Existing Competition

40. The estimated market shares in the Wellington electrical products market based on the dollar value of sales at the wholesale level are set out in Table 1 below.

Table 1: Estimated Market Shares for the Wellington Electrical Products Market

Supplier	Value of Sales (\$000)	%
Redeal	[]	[]
Egley	[]	[]
<i>Merged Entity</i>	[]	[]
Advance	[]	[]
Crane	[]	[]
Stewarts	[]	[]
Stemco	[]	[]
<i>Total</i>	[]	100

Source: Commission estimates

41. Table 1 shows that the merged entity would account for a market share of around [] % and the three-firm concentration ratio would be []. The market shares fall outside the safe harbour guidelines.
42. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission also considers the behaviour of the businesses in the market.
43. The acquisition would result in the merged entity becoming the largest single wholesaler of electrical products in the Greater Wellington market. However, the Commission considers that the merged entity would continue to face strong competition from other markets participants in the factual.
44. In particular, the Commission considers that Advance would provide a strong constraint on the merged entity with branches throughout Greater Wellington and with an estimated market share of around []%. Advance has advised the Commission that it could readily increase its market share if the merged entity were to raise its prices by 5 to 10% post-acquisition.
45. Similarly, the Commission considers that Crane would provide a constraint in the factual. It currently has a market share of around []%. Crane is part of Crane Group Limited, a publicly listed Australian company, which supplies electrical and plumbing products from its branch network throughout New Zealand. Crane advised the Commission that it has opened four new branches in the North Island within the last 12 months, and could readily do so to add to its existing 8 branches in the Greater Wellington region, if the circumstances warranted it. Further, it considers there are no obstacles to the company expanding its operations in the event that the merged entity increased its prices post- acquisition.
46. Aside from Advance and Crane, the Commission considers that Stewarts would provide some constraint in the factual. Given that Stewarts already has 10 branches throughout the lower North Island, and with an existing branch in the affected

market, the Commission considers it has the potential to expand its existing market share post-acquisition if the merged entity were to raise its prices.

47. In addition to the competition provided by existing wholesale suppliers, the Commission considers that many importers/manufacturers can and do bypass wholesalers on occasions and supply electrical products direct to end user customers, although the scale of such transactions varies depending on the specific product. Accordingly, such parties would provide some constraint on the merged entity in the factual.
48. Similarly, the Commission has been advised that many electrical products are sold through the merchant chains (e.g. Bunnings and Placemakers), who are able to take advantage of their buying power with suppliers. Although not considered a direct constraint on electrical wholesalers, the Commission has been advised by industry participants that the prices offered by the merchant chains often provide a reference point especially for consumer items when electrical contractors negotiate prices with electrical wholesalers.
49. The Commission considers, therefore, that in relation to the counterfactual, the merged entity would be so constrained by existing competition in the factual scenario, and there is unlikely to be an effect of substantial lessening of competition when the two are compared.

Potential Competition

50. The Applicant submits that there are low barriers to entry or expansion into the supply of electrical products, noting that there are:
 - no significant regulatory barriers;
 - low expansion barriers; and
 - an absence of supply constraints.
51. The Commission has identified the key requirements for entry (and expansion) as:
 - access to premises;
 - stock; and
 - suitable staff
52. The Commission's enquiries have revealed that none of these entry/expansion conditions are onerous. Suitable premises can be easily rented or leased. The Applicant submits, and industry participants agree, that stock can be purchased for an outlay of around \$250,000- \$400,000. Wholesalers have informed the Commission that there is a limited pool of personnel with the appropriate expertise. However, this is unlikely to constitute a major obstacle for an existing operator in the market.
53. There are no recent examples of de novo entry in the relevant market. However the Commission has identified examples of existing wholesalers expanding by establishing a new branch. For instance, Advance has recently established a second

branch in Wellington city to supplement its existing city branch, while Egley established a branch in Petone in 2001, both with apparent ease.

54. Further, as noted previously, J A Russell has been identified as a likely new entrant in the relevant market. The Commission considers that J A Russell could enter with relative ease, especially if the merged entity attempted to exercise any market power post-acquisition.
55. For these reasons, the Commission considers that there are no significant barriers to entry (or expansion) in the affected market, and that entry/expansion could readily be achieved within a six to 12 month timeframe. Potential competition is, therefore, likely to provide a constraint on the merged entity in the factual.

Countervailing Power of Acquirers

56. Electrical contractors often maintain multiple accounts with electrical wholesalers, and while many often have a preferred supplier, the Commission has been advised by market participants that they closely monitor prices and that they can and do switch suppliers with relative ease or negotiate more favourable pricing with their preferred supplier. While a number of strong alternative competitive options remain, such purchasers can and do switch.
57. Accordingly, the Commission considers that the merged entity would continue to be constrained by the countervailing power of its customers in the factual.

Conclusion on Competition Analysis

58. The Commission concludes that in the Wellington electrical products market, there is unlikely to be a substantial lessening of competition compared to the counterfactual as the merged entity is likely to face constraints from:
 - two major existing competitors, Advance and Crane;
 - potential competition; and
 - the countervailing power of customers.

OVERALL CONCLUSION

59. The Commission is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in the Wellington electrical products market.

DETERMINATION ON NOTICE OF CLEARANCE

60. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Redeal Limited, or any of its interconnected bodies corporate, of 100% of the assets and business of Egley Electrical Co Limited and Egley Electrical Petone Limited in Wellington.

Dated this 12th day of June 2008

Peter J M Taylor
Division Chair
Commerce Commission