COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

ISBN 978-1-869454-65-4

Statement of Preliminary Issues

Z Energy Limited / Chevron New Zealand

6 August 2015

Introduction

1. Z Energy Limited (Z, or the Applicant) is proposing to acquire 100% of the shares in Chevron New Zealand (Chevron), the owner of the Caltex brand in New Zealand. On 1 July 2015, the Commerce Commission registered an application from Z seeking clearance for the proposed acquisition.[1]

2. The Commission will give clearance if it is satisfied that the acquisition will not have or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This Statement of Preliminary Issues outlines the key competition issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed acquisition. We request that parties who wish to make a submission do so by **21 August 2015**.

The parties

5. Z is a supplier of petroleum products in New Zealand and has interests throughout the supply chain. Z is a shareholder in The New Zealand Refining Company Limited (NZRC) that operates the oil refinery at Marsden Point and it has interests in fuel storage terminals, pipelines and logistic services used for the distribution of fuel around New Zealand. Z supplies wholesalers and commercial customers with a range of fuels including petrol, diesel, aviation fuels, marine fuels and bitumen. Z also retails petrol and diesel through its Z-branded service stations.

6. Chevron is also a supplier of petroleum products with interests throughout the supply chain. Chevron has interests in fuel storage terminals, pipelines and logistic services throughout New Zealand[3] and supplies wholesalers and commercial customers with a range of fuels including petrol, diesel, aviation fuels, marine fuels and bitumen. It also supplies petrol and diesel through its Caltex service stations.

---

1 The public version of the application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/865

2 The issues highlighted in this statement are based on the information available at the time of publication and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.

3 Chevron no longer has a shareholding in NZRC. Chevron sold its shares in NZRC in advance of the proposed acquisition. See Z's clearance application at [69].

7. Z and Chevron, along with BP Oil New Zealand Limited (BP) and Mobil Oil New Zealand Limited (Mobil) (together, the major fuel firms), individually and jointly own most of the assets used to distribute petroleum products in New Zealand. The use of the assets is governed through joint venture agreements and other arrangements between the firms.

Our framework

8. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[4] As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

9. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[5]

10. We define markets in the way that we consider best isolates the key competition issues that arise from the acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[6]

11. We compare the extent of competition in each relevant market both with and without the acquisition. This allows us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we will not give clearance to the proposed acquisition. When making that assessment, we consider, among other matters:

    11.1 existing competition – the degree to which existing competitors compete;

    11.2 potential competition – the extent to which existing competitors would expand their sales or new competitors would enter the market and compete effectively if prices were increased; and

    11.3 the countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser's ability to exert substantial influence on negotiations.

Potential overlap in New Zealand

12. Z and Chevron are involved in petroleum products throughout the supply chain. There may be actual or potential overlap for:

---

4 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

5 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

6 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

12.1 purchasing processing capacity from NZRC;

12.2 services provided using distribution assets including:

12.2.1 coastal shipping;

12.2.2 pipelines;

12.2.3 truck loading facilities;

12.2.4 road transport;

12.2.5 storage terminals; and

12.2.6 aviation fuel refuelling equipment.

12.3 the wholesale of petroleum products to other fuel suppliers;

12.4 the commercial supply of:

12.4.1 aviation fuels;

12.4.2 marine fuels;

12.4.3 bitumen;

12.4.4 petrol;

12.4.5 diesel;

12.4.6 kerosene; and,

12.4.7 lubricants.

12.5 the retail supply of:

12.5.1 petrol;

12.5.2 diesel;

12.5.3 kerosene; and

12.5.4 lubricants.

12.6 a franchise market in which fuel companies compete for the provision of franchise agreements to independent retailers.

13. For ease of explanation, we will refer to those products and services relating to refinery and distribution assets as “input” markets and refer to those products and services listed under wholesale, commercial, retail and franchise as “output” markets.

Summary of the Applicant's submissions

14. The Applicant submits that the proposed acquisition would not result in a lessening of competition for the use of distribution assets because:[7]

    14.1 any ability of the merged entity to exercise market power is limited by the fact that other market participants control assets that would be critical to the merged entity's business;

    14.2 the transaction would not affect the terms of the joint ventures, which prevent individual firms from exercising market power over others; and

    14.3 the total set of distribution assets would continue to be operated without change, or more efficiently.

15. The Applicant submits that the proposed acquisition would not result in a lessening of competition for commercial sales because:[8]

    15.1 Z and Chevron are not strong competitors in some markets;[9]

    15.2 the merged entity will continue to face competition from the other major fuel firms, Gull New Zealand Limited (Gull), and, in some cases, distributors;[10]and

    15.3 some customers will have countervailing power such as the ability to import directly themselves.[11]

16. The Applicant submits that the proposed acquisition would not result in a lessening of competition for retailing petrol and diesel because:[12]

    16.1 Chevron and Z do not impose a strong constraint on one another. Chevron's operating model means it does not set retail prices. Economic analysis submitted with the Application shows that the presence of a Caltex service station does not significantly affect Z's prices;

    16.2 there would remain strong competition from other retailers with a range of ownership models and differentiated service offerings; and

---

7 Application at [3.1].

8 Application at [3.2].

9 The Applicant submits that: Z and Chevron only overlap for the supply of aviation fuel at Auckland airport; Chevron is not a significant participant for the supply of marine fuel; Z and Chevron supply only a small amount of kerosene; and Z does not wholesale lubricant or offer direct supply to commercial customers. See the Application at [3.2], n 4.

10 The Applicant submits that the merged entity would continue to face these competitors: BP and Mobil for aviation fuel at Auckland Airport; BP and Mobil for marine fuel; BP, Mobil, and (sometimes) Gull for the supply of petrol and diesel to independent distributors and retailers; and BP, Mobil, distributors and (sometimes) Gull for commercial supply of petrol and diesel. See the Application at [3.2].

11 The Applicant submits that imports are possible for customers of bitumen and one or a consortium of large distributors of petrol and diesel. See the Application at [3.2(c)], [3.2(d)(ii)]. The Applicant also submits that customers of jet fuel will have countervailing power. See the Application at [3.2(a)].

12 Application at [3.3].

16.3 entry or expansion could occur through expansion by existing players, such as g.a.s and Gull, securing wholesale supply from the major fuel firms, or directly importing fuel.

Preliminary issues

17. The questions that we will be focusing on when assessing whether the proposed acquisition is likely to substantially lessen competition in the relevant markets are:

17.1 would the merged entity be able to raise prices or reduce quality by itself?[13]

17.2 would the merged entity be able to raise its rivals' costs?

17.3 would the merged entity be able to coordinate with rivals to raise prices?

Would the merged entity be able to raise prices by itself?

18. Where two suppliers compete in the same market, a merger would eliminate the competition between them.[14] The merger could remove a competitor that would otherwise provide a competitive constraint, allowing the merged entity to raise prices. A merger could also reduce competition if the target was a potential or emerging competitor. In such a case, the merger may preserve the market power of the incumbent firm.

19. We are, at this stage, generally concerned with the ability of the merged entity to raise prices in the input and output markets outlined above. To assess whether the proposed acquisition may allow the merged entity to raise prices in the areas of potential or actual overlap, we will consider four main issues.

20. First, how closely Z and Chevron compete against one another. We will assess whether customers view the product or service that Z and Chevron offer as being close substitutes. Z and Chevron might not be as close competitors as other rivals if, for example, they offer a differentiated service[15] or do not supply customers in a certain area.

21. Secondly, the degree of constraint that rival suppliers provide. We will assess whether:

21.1 current competitors (mainly BP and Mobil but also Gull in some areas) are willing and able to replace the competition lost as a result of the merger;

21.2 the extent to which distributors, who source their product from one of the major fuel firms, impose a constraint. We will need to identify:

---

13 There are many dimensions on which competition can take place including price, quality, range, innovation, and service. In the rest of the paper we use "price" as a short-hand for all of those dimensions.

14 Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [3.62].

15 For example, the joint venture that Chevron is involved in for aircraft refuelling at Auckland airport owns larger trucks than the joint venture that Z is involved in. These trucks are more suitable for larger aircraft. See the Application at [142(d)].

21.2.1 those markets in which distributors are present;

21.2.2 the nature of the agreements between the major fuel firms and the distributor; and

21.2.3 whether the distributors provide significant competitive constraint.

22. Thirdly, whether the threat of entry and expansion would provide a constraint on the merged entity. We will assess how difficult it is for a new entrant to start supplying the market or for a current competitor to expand. To enter or expand in commercial markets requires access to supply of refined product. This could be achieved through gaining access (or increased access) to capacity at the refinery or importing.[16] We will assess whether the terms under which major fuel firms obtain refined product from the refinery makes it hard for rivals (such as Gull and/or a potential entrant) to profitably import.

23. Fourthly, whether customers have any countervailing power. We will assess whether customers have special characteristics that would allow them to resist a price increase by the merged entity.[17] This might include sponsoring entry or vertically-integrating through self-supply (or importing).

Would the merged entity be able to raise its rivals' costs?

24. The fuel industry is characterised by competitors that are vertically integrated, ie, they operate at different levels of the supply chain. As such, certain competitors in the output markets rely on each other for the provision of services in the input markets. This has a potential two-fold effect.

25. The first of these two effects is the likelihood of enhanced market power in the sale of input services, such as the sale of terminal storage. We will consider this in our assessment above of whether the merged entity could raise prices.

26. The second effect is whether any enhanced market power over inputs provides the merged entity an opportunity to raise rivals' costs by worsening rivals' terms relating to those inputs, including by increasing the price or limiting access.[18] This worsening of terms could be over and above what would occur from the mere exercise of market power. This in turn could result in a substantial lessening of competition in the related output market.

27. The inputs that could be used in this way include those that the fuel companies jointly own or operate (such as pipelines), as well as wholly owned assets (such as certain terminals).

28. We will consider the following issues:

---

16 A new entrant could also obtain supply of refined product through investing in a new refinery. The Application considers this less likely than entry by importing. The Application at [82].

17 Where only some firms have countervailing power, it may not prevent the merger from substantially lessening competition if the merged entity could raise prices to the rest of the market.

18 In the extreme, access to an input may be denied.

28.1 whether the merged entity has market power at one or more levels of the supply chain in which it operates;

28.2 whether the merged entity would have the incentive to worsen the input terms to its rivals (including denying access) beyond any incentive to merely maximise profits. This requires testing whether the merged entity would be better off decreasing the competitiveness of its rival in the output market so that the merged entity can enhance its own market power in that market, or whether it is better off making more sales to those rivals in the input market. In some markets, Z or Chevron might already have market power. However, the merger might enhance the incentive for the merged entity to raise rivals' costs because, with the merger, the merged entity is in a better position to take advantage of a weakened competitor in the output market; and

28.3 whether this will have the effect of substantially lessening competition in any of the affected markets.

29. In the case of inputs jointly owned by the merged entity and other competitors, part of our consideration will be whether the merged entity would gain additional control over an input either through a greater share of ownership or through its share of capacity. The merged entity would increase its ownership share of the joint ventures that operate inputs and would also have the rights to a large share of NZRC processing capacity. We will assess whether these arrangements might place the merged entity in a position to raise its rivals' costs.

Would the merged entity be able to coordinate with rivals to raise prices?

30. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[19] We would need to assess whether the merger increases the potential for coordination or whether the merger would be likely to enhance existing coordination.

31. We will assess whether any of the input and output markets are vulnerable to coordination, and whether the merged entity would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable. Some of the factors we will consider are:

31.1 whether the characteristics of the product or service makes coordination likely. This may be the case when:

31.1.1 the products are homogenous;

31.1.2 there is little innovation and stable demand;

[19] Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [3.84].

31.1.3 firms can easily observe each other's prices; and

31.1.4 there is repeated interaction;

31.2 whether the merger will leave any markets with only a few rivals or eliminate a vigorous competitor;

31.3 whether the firms in the market are similar (for example, in size and cost structure) such that they will have similar incentives to coordinate;

31.4 whether the joint ventures and agreements between the major fuel firms enhance the potential for coordination; and

31.5 whether the threat of entry or the countervailing power of customers or suppliers would disrupt any attempts to coordinate.

32. We will need to consider whether coordination is already occurring. If this is the case then we must assess the extent to which the merger would enhance this coordination.

Next steps in our investigation

33. The Commission is currently aiming to make a final decision on whether or not to give clearance to the merger by **18 December 2015.** However, this date may change as our investigation progresses.[20]

34. As part of our investigation, we will be identifying and contacting parties we consider will be able to help us assess the preliminary issues identified above.

Making a submission

35. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Z/Chevron in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business **21 August 2015**. As we intend to publish public versions of the submissions we receive on our website, please clearly identify any confidential information contained in your submission and provide both a confidential and a public version, if applicable.

36. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. For example, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.

---

[20] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.