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Decision No 597

Determination pursuant to the Commerce Act 1986 in the matter of an application for Proposal

BOC LIMITED

and

SHELL NEW ZEALAND LIMITED

The Commission:	Paula Rebstock Denese Bates, QC Peter JM Taylor
Summary of Application:	The acquisition by BOC Limited of Shell New Zealand Limited's LPG business and Shell New Zealand Holding Company Limited's shareholdings in Liquigas Limited.
Determination:	Pursuant to Section 66 (3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
Date of Determination:	21 February 2007

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EXECUTIVE SUMMARY

E1. A notice pursuant to s 66(1) of the Commerce Act 1986 was registered on 18 December 2006. The Notice sought clearance for the acquisition by BOC Limited of Shell New Zealand Limited’s liquefied petroleum gas (LPG) business and Shell New Zealand Holding Company Limited’s shareholding in Liquigas Limited.

E2. The Commission considers the relevant markets to be:

- the market for the retail of LPG in the Canterbury region; and
- the market for the retail of LPG in the Nelson/Marlborough region.

E3. The Commission considers the likely counterfactual scenario to be that Shell New Zealand Limited’s LPG business and Shell New Zealand Holding Company Limited’s shareholding in Liquigas Limited would be sold to a third party that would not give rise to a substantial lessening of competition in any market.

E4. The Commission considers that in the factual scenario the combined entity will continue to face constraint from existing competitors, in the form of vertically-integrated LPG companies, third party retailers and service stations, in both the Canterbury and Nelson/Marlborough regions.

E5. Furthermore, the Commission considers that the combined entity will face additional constraint from Shell service stations, which are effectively preserved as a competitor to the combined entity.

E6. As BOC is not currently involved in the distribution of LPG or the wholesale supply of LPG, the Commission considers that it is unlikely that the scope for market power at the wholesale level, and therefore vertical integration effects, will be enhanced by the proposed acquisition.

E7. The Commission is therefore satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in any market.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 18 December 2006. The notice sought clearance for the acquisition by BOC Limited of Shell New Zealand Limited's liquefied petroleum gas (LPG) business and Shell New Zealand Holding Company Limited's shareholdings in Liquigas Limited (Shell's LPG Portfolio).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear 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 23 February 2007.

3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 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 approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.[1]

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have the effect of substantially lessening competition in the market. If the Commission is satisfied that the proposal is not 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 standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

6. 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]

7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is not minimal.[4]

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines, January 2004*.
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[3] *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.
[4] Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

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.

8. 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 give case.

9. 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

10. 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 access 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).

11. 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 competition factors, such as the countervailing market power of buyers or supplies.

THE PARTIES

BOC Limited (BOC)

12. BOC is part of the Linde Group. Its ultimate parent company is Linde AG, a German company that was formed by the merger of Linde AG and the BOC Group plc in September 2006. The Linde Group is involved in industrial gases and engineering in 70 countries, including New Zealand.

Shell New Zealand Limited

13. Shell New Zealand Limited is a subsidiary of Shell New Zealand Holdings Limited and Shell Petroleum Mining Limited. These parties are collectively referred to in this Decision as Shell. Shell is part of the Royal Dutch/Shell group of companies. It is ultimately owned by Royal Dutch Shell plc. Royal Dutch/Shell companies are involved in activities relating to oil, natural gas, chemicals, electricity generation and renewable resources in more than 135 countries.

14. In New Zealand, Shell is active in all of the above listed industries. In particular, Shell is involved in the exploration and production of oil and gas in the Maui, Pohukura and Kapuni fields; the wholesale supply of LPG throughout New Zealand; retail of LPG through its Allgas division in Nelson and The Gas Company in Christchurch; and the operation of approximately 350 Shell-branded petrol stations across New Zealand.

OTHER PARTIES

Liquigas Limited (Liquigas)

15. Liquigas Ltd provides LPG storage and distribution services to LPG wholesalers, and has terminals located in Auckland, New Plymouth, Christchurch and Dunedin. Shareholders in Liquigas are Todd Petrogas Limited (Todd), Rockgas Limited and Vector Limited, all of whom are wholesalers of LPG.

Rockgas Limited (Rockgas)

16. Rockgas is a wholly-owned subsidiary of the Australian company Origin Energy LPG Limited. Rockgas sells approximately [ ] tonnes of LPG per annum, and is the largest LPG company in New Zealand. Rockgas is a vertically-integrated LPG company; it is involved in the wholesale supply of LPG, has a number of reticulation networks, and is a retailer of LPG throughout New Zealand.

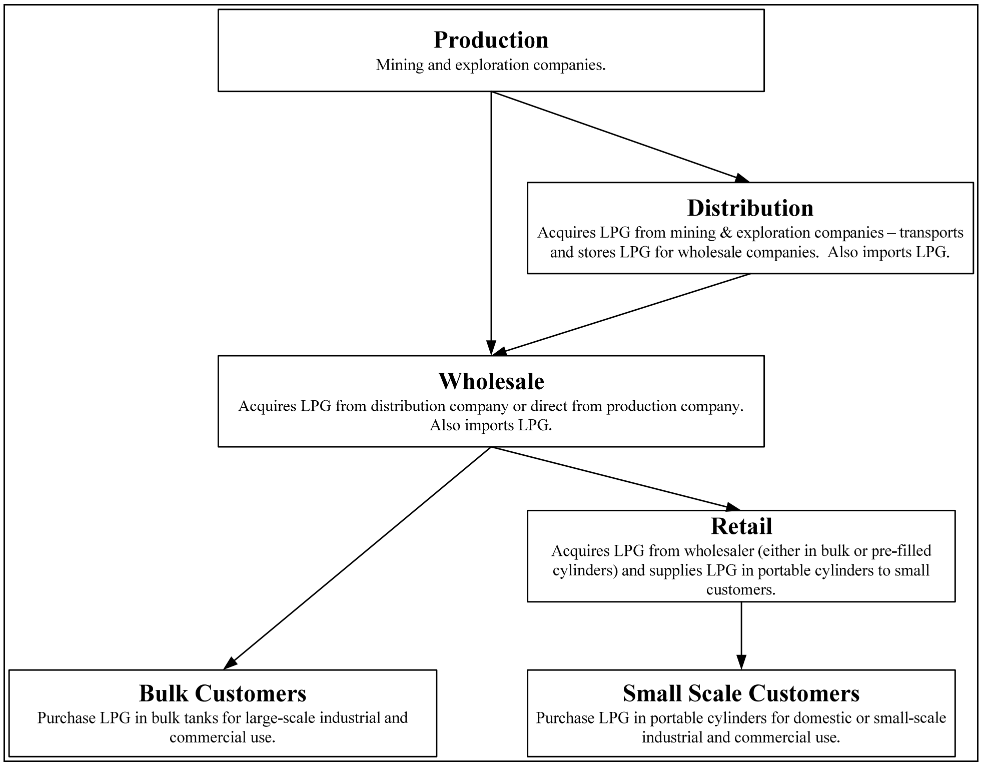
Ongas Limited (Ongas)

17. Ongas is also a vertically-integrated LPG company. Ongas is a wholly-owned subsidiary of Vector Limited (Vector). Vector is involved in the production and distribution of LPG. Ongas itself is involved in the wholesale supply of LPG, has a reticulated network in Christchurch and is a retailer of LPG throughout New Zealand.

INDUSTRY BACKGROUND

18. LPG is a by-product of the production of natural gas. It comprises either propane, butane or a mixture of the two. The physical properties of these two gases are such that alone, or as a mixture, they can be liquefied under moderate pressures and at normal temperatures. Figure 1 summarizes the different operational levels of the LPG industry.

Figure 1: The LPG Industry



Source: Industry Participants

Production

19. Historically production in New Zealand of LPG has been dominated by the Maui and Kapuni gas fields; however, there are an increasing number of other gas fields coming on-line.

Distribution

20. Liquigas is the sole operator at the distribution level in New Zealand. It has a contract to purchase LPG from the Maui Mining Companies, and distributes LPG to its wholesale customers, which pay a tolling fee for this service. LPG is on occasion imported, usually when there is a domestic product shortage when heating demand is at its highest in the colder months.[5]

Wholesale

21. Availability of LPG can be a constraint at the wholesale level. Wholesalers have also been known to import LPG when domestic product is insufficient. There are a large number of wholesale suppliers, most of which are vertically-integrated LPG companies, such as Rockgas. LPG wholesalers supply LPG to retailers, and directly supply LPG to large-scale bulk customers.

[5] Historically there has been a price differential between imported and domestically-produced LPG.

Retail

22. At the retail level, LPG is supplied by vertically-integrated operators, such as Ongas, third party retailers and service stations. LPG is typically supplied in cylinder sizes ranging from 9kg - 45kg. LPG is also delivered via reticulated supply in some regions.

PREVIOUS COMMISSION DECISIONS

23. The Commission previously considered LPG retail markets in Decision 456, *Shell New Zealand Limited/The Gas Company Limited*, March 2002. In this Decision, the Commission considered the retail market for LPG in the Christchurch region. The Commission granted clearance for the acquisition on the basis that the combined entity would continue to face constraint from existing competition in the factual scenario.

MARKET DEFINITION

24. 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.'[6]

25. For the purpose of competition analysis, the internationally accepted approach is to assume the 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 would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increases in price that is sustained for a period of one year.

26. The Applicant submitted the market definitions identified by the Commission in its previous Decision continue to apply in this instance - the relevant markets being:
    - the national LPG distribution market;
    - the national wholesale LPG market; and
    - the various regional retail LPG markets.

Product Market

27. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.

28. 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.

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[6] S 3(1) of the Commerce Act 1986.

29. 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 to their relative prices.

30. LPG is a by-product of natural gas production and, to this extent, the quantity of LPG produced is dependant upon natural gas production volumes. However, the Commission previously considered that LPG comprises a discrete market, as there is limited scope for supply-side substitutability.

31. On the demand-side, the extent to which different customers can substitute different fuel types varies. Some applications are LPG-specific, whilst others are more flexible. Although switching may be feasible in some cases, LPG appears to offer significant advantages that impact upon the cost-effectiveness of substituting a different fuel type.

Conclusion on Product Market

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

Functional Markets

33. The production, distribution, and sale of a product typically occur through a series of functional levels, conventionally arranged vertically in descending order. Generally the Commission identifies separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each. For the purposes of this acquisition changes will occur at the distribution level, wholesale level and retail level.

34. As BOC is not involved in either the distribution or wholesale levels, the acquisition is unlikely to result in any horizontal aggregation at these levels. To this extent the Commission has not considered these levels further in respect of this acquisition. The proposed acquisition is likely to result in horizontal aggregation at the retail level, as both BOC and Shell are involved in the retail of LPG.

35. Accordingly, the Commission concludes that the appropriate functional market for the purpose of assessing the current Application is the retail of LPG.

Geographic Markets

36. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

37. The Applicant submitted that the relevant market is a regional retail market for LPG.

38. In Decision 456 the Commission considered that the geographic extent of the market for the retail of LPG was regional, as from a demand-side perspective customers were unlikely to travel significant distances to purchase LPG. On the supply side, LPG retailers tend to be located within close proximity to their customer-base to ensure effective and timely supply.

39. Industry participants advised the Commission that there has been no material change since Decision 456. Vertically-integrated firms with national presence, such as Rockgas and Shell, tend to have retail branches[7] located regionally in order to best serve their customers.

40. Accordingly, the Commission considers the geographic dimension of the LPG retail market to be regional. As Shell's service stations are not subject to the proposed acquisition, the only regions in which aggregation will occur as a result of this acquisition are Nelson/Marlborough and Canterbury.

Conclusion on Geographic Markets

41. The Commission concludes that the appropriate geographic market is a regional market for LPG retail, and the geographic markets relevant for the purpose of assessing this Application are Nelson/Marlborough and Canterbury.

CONCLUSION ON MARKET DEFINITION

42. For reasons discussed above, the Commission concludes that the relevant markets in respect of the proposed acquisition are:

- the market for the retail of LPG in the Canterbury region; and
- the market for the retail of LPG in the Nelson/Marlborough region.

COUNTERFACTUAL AND FACTUAL

43. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).[8] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

44. The Commission considers that the appropriate factual to be that BOC will own and manage Shell's LPG portfolio assets that are subject to the proposed acquisition, and Shell will continue to own and operate certain LPG retail facilities not subject to the proposed acquisition (including Shell service stations).

Counterfactual

45. Shell has determined that it will dispose of its LPG portfolio assets, and the sale of Shell's LPG Portfolio was a tender process. BOC was one of a number of interested parties, [ ]. To this end, the Commission considers that the most likely counterfactual is that Shell's LPG portfolio would be acquired by a third party that would not give rise to a substantial lessening of competition in any market.

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[7] These retail branches may be either in the form of agencies, third party distributors, service stations, or subsidiaries.

[8] *Air New Zealand & Qantas Airways Ltd v Commerce Commission* (No.6), unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.

COMPETITION ANALYSIS

Nelson/Marlborough Region

Existing Competition

46. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

47. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

48. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

    - 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 persons or associated persons) has less than in order of 40% share; or

    - 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%.

49. The Commission has measured market shares for the retail of LPG in terms of volume of LPG supplied to each retail channel by wholesale suppliers. These figures are presented in Table 1 below.

Table 1: Volume of LPG Supplied to Each Retail Channel in the Nelson/Marlborough Region: January 2006 - January 2007

LPG Retailer	Volume of LPG (tonnes)	Volume of LPG (%)
Rockgas Agencies	[ ]	[ ]%
Allgas (Shell)	**[ ]**	**[ ]%**
BP	[ ]	[ ]%
Caltex/Mobil Service Stations	[ ]	[ ]%
Shell Service Stations	[ ]	[ ]%
BOC Gas 'n' Gear	**[ ]**	**[ ]%**
Ongas	[ ]	[ ]%
4 Seasons	[ ]	[ ]%
TOTAL	**[ ]**	**100%**
Combined Entity	**[ ]**	**[ ]%**
Current CR3	**[ ]**	**[ ]%**
Post Acquisition CR3	**[ ]**	**[ ]%**

Source: Industry Participants

50. Table 1 indicates that BOC currently has a market share of [ ] %, which will increase to [ ] % in the factual. The three-firm concentration ratio will in turn increase from [ ] % to [ ] % post-acquisition. This falls within the Commission's safe harbour guidelines.

51. 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 considers the behaviour of the businesses in the market.

52. There are a number of retailers in the form of vertically-integrated companies such as Ongas, and third-party retailers, in the form of 4 Seasons, Rockgas agencies and service stations, which presently operate in the Nelson/Marlborough region. The Commission is of the view that these retailers will continue to constrain the combined entity in the factual scenario.

53. The sale of Shell's LPG portfolio is [

]. The Commission therefore considers that Shell service stations will effectively be preserved as a competitor, and will continue to act as a constraint on the combined entity in the factual scenario.

Conclusion on Existing Competition

54. The Commission considers that the combined entity will continue to face constraint from existing competitors in the form of vertically-integrated LPG firms, such as Ongas, and third party retailers such as 4 Seasons, Rockgas agencies and service

stations, in the factual scenario. Furthermore, the Commission is of the view that Shell service stations will effectively be preserved as a competitor, and will continue to constrain the combined entity in the factual scenario.

Conclusion on Nelson/Marlborough Region

55. The Commission considers that the combined entity will continue to face constraint from existing competition, including vertically-integrated LPG firms and third party retailers, in the factual scenario. In addition, the combined entity will also face constraint from Shell service stations, which will effectively be preserved as a competitor to the combined entity in the factual scenario.

56. Accordingly, the Commission concludes the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in the market for the retail of LPG in the Nelson/Marlborough region.

Canterbury Region

Existing Competition

57. The Commission has measured market shares for the retail of LPG in terms of volume of LPG supplied to each retail channel by wholesale suppliers. These figures are presented in Table 2 below.

Table 2: Volume of LPG Supplied to Each Retail Channel in the Canterbury Region: January 2006 – January 2007

LPG Retailer	Volume of LPG (tonnes)	Volume of LPG (%)
Rockgas	[ ]	[ ]%
Ongas	[ ]	[ ]%
Caltex/Mobil Service Stations	[ ]	[ ]%
The Gas Company (Shell)	**[ ]**	**[ ]%**
Rockgas Agencies	[ ]	[ ]%
BP	[ ]	[ ]%
Shell Service Stations	[ ]	[ ]%
BOC Gas 'n' Gear	**[ ]**	**[ ]%**
Ongas Agent	[ ]	[ ]%
TOTAL	**[ ]**	**100%**
Combined Entity	**[ ]**	**[ ]%**
Current CR3	**[ ]**	**[ ]%**
Post Acquisition CR3	**[ ]**	**[ ]%**

Source: Industry Participants

58. Table 2 shows that BOC's market share will increase from [ ] % to [ ] %, but the three-firm concentration ratio does not increase in the factual scenario. This falls within the Commission's safe harbour guidelines.

59. There are a number of vertically-integrated LPG firms, in the form of Rockgas and Ongas, and third-party retailers, in the form of agencies and various service stations,

which presently operate in the Canterbury region. The Commission is of the view that these retailers will continue to constrain the combined entity in the factual scenario.

60. As discussed in the context of the Nelson/Marlborough region, the Commission considers that the Shell service stations will effectively be preserved as a competitor, and will therefore continue to act as a constraint upon the combined entity in the factual scenario.

Conclusion on Existing Competition

61. The Commission considers that the combined entity will continue to face constraint from existing competitors in the form of vertically-integrated LPG firms, such as Rockgas and Ongas, third party distributors such as agencies and service stations in the factual scenario. Furthermore, the Commission is of the view that Shell services stations are effectively preserved as a competitor, and will act as an additional constraint upon the combined entity in the factual scenario.

Conclusion on Canterbury Region

62. The Commission considers that the combined entity will continue to face constraint from existing competition, including vertically-integrated LPG firms and third party retailers, in the factual scenario. In addition, the combined entity will also face constraint from Shell service stations, which are effectively preserved as competitors to the combined entity.

63. Accordingly, the Commission concludes the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in the market for the retail of LPG in the Canterbury region.

Vertical Integration

64. Vertical acquisitions are those that involve businesses operating at different functional market levels in the production of a particular good or service. Where a vertical acquisition also has horizontal implication, the Commission considers each aspect of the acquisition in its own right. The Commission is of the view that, 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 market power exists at one of the affected functional levels.

65. As BOC is not currently involved in the distribution of LPG or the wholesale supply of LPG, the Commission considers that it is unlikely that the scope for market power at the wholesale level, and therefore vertical integration effects, will be enhanced by the proposed acquisition.

OVERALL CONCLUSION

66. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the markets for:

- the market for the retail of LPG in the Canterbury region; and
- the market for the retail of LPG in the Nelson/Marlborough region.

67. The Commission considers the likely counterfactual scenario to be that Shell's LPG portfolio would be sold to a third party that would not give rise to a substantial lessening of competition in any market.

68. The Commission considers that in the factual scenario the combined entity will continue to face constraint from existing competitors, in the form of vertically-integrated companies, third party retailers and service stations, in both the Nelson/Marlborough and Canterbury regions.

69. Furthermore, the Commission considers that the combined entity will face additional constraint from Shell services stations, which are effectively preserved as a competitor to the combined entity.

70. As BOC is not currently involved in the distribution of LPG or the wholesale supply of LPG, the Commission considers that it is unlikely that the scope for market power at the wholesale level, and therefore vertical integration effects, will be enhanced by the proposed acquisition.

71. The Commission is therefore satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in any market.

DETERMINATION ON NOTICE OF CLEARANCE

72. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by BOC Limited of Shell New Zealand Limited's liquefied petroleum gas (LPG) business and Shell New Zealand Holding Company Limited's shareholding in Liquigas Limited.

Dated this 21st day of February 2007

Paula Rebstock

Paula Rebstock
Chair
Commerce Commission