

## Statement of Preliminary Issues

### Tennex Capital Limited / San-i-pak Limited

21 September 2018

#### Introduction

1. On 17 September 2018, the Commerce Commission (Commission) registered an application (the Application) from Tennex Capital Limited (Tennex, or the Applicant) seeking authorisation to acquire up to 100% of the medical and quarantine waste collection and treatment assets of San-i-pak Limited (San-i-pak) (the proposed acquisition).<sup>1</sup>
2. The Commission will grant authorisation if it is satisfied that the proposed acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant authorisation.<sup>2</sup>
4. We invite interested parties to provide comments on the likely competitive effects, detriments and benefits of the proposed acquisition. We request that parties who wish to make a submission do so by **Friday, 12 October 2018**.

#### The parties

5. Tennex provides medical and quarantine waste collection, treatment and disposal services through its subsidiary, International Waste Limited (IWL). IWL operates facilities for the treatment of medical and quarantine waste in Auckland, Wellington, Christchurch and Dunedin. It collects medical and quarantine waste on a national basis for processing at its treatment facilities. IWL also provides disposal and recycling services for other products such as fluorescent tubes.
6. San-i-pak provides medical and quarantine waste collection, treatment and disposal services, as well as general waste services. It operates a single facility for the treatment of medical and quarantine waste in Christchurch. San-i-pak collects medical and quarantine waste primarily in the greater Canterbury region.
7. IWL and San-i-pak are the only parties that currently undertake treatment of medical and quarantine waste in the South Island.<sup>3</sup>

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<sup>1</sup> A public version of the Application is available on our case register on our website at: <https://comcom.govt.nz/case-register/case-register-entries/tennex-capital-limited-san-i-pak-limited>.

<sup>2</sup> The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

## Background to the transaction

8. The Commission has previously considered this acquisition in a clearance context. On 29 February 2016, the Commission declined to give clearance to Tennex to acquire the medical and quarantine waste collection and treatment assets of San-i-pak.<sup>4</sup> The Commission declined to give clearance for the reasons summarised below.<sup>5</sup>
  - 8.1 IWL and San-i-pak are the only parties in the South Island currently providing treatment and disposal of medical and quarantine waste services. With the acquisition, IWL would (absent new entry) be the only supplier (ie, the market would go from being a duopoly to a monopoly). Conversely, without the acquisition, the treatment and disposal of medical and quarantine waste services offered by San-i-pak would continue to be available independent of Tennex in competition with IWL.
  - 8.2 We were not satisfied that, faced with a price increase, large customers would have sufficient countervailing power or incentive to use what power they have in order to constrain the merged entity and offset a substantial loss of competition, given that they would have few strong alternative options to a merged IWL/San-i-pak or it would be costly to self-supply.
  - 8.3 Smaller customers that pay list prices and which have no alternatives to a merged IWL/San-i-pak were likely to face price increases post-acquisition of a magnitude that would be substantial.
  - 8.4 We were not satisfied that new entry into the South Island market for the treatment and disposal of medical and quarantine waste services would be likely, of sufficient extent and would occur in a timely enough way to constrain the merged entity.
9. Tennex now seeks authorisation to acquire the medical and quarantine waste collection and treatment assets of San-i-pak. In its application for authorisation, Tennex stated that it does not seek to revisit the Commission's analysis in its 2016 clearance decision. Tennex and San-i-pak both accept the analysis in that decision for the purpose of considering the competitive effects of the proposed acquisition. The Application instead focusses on arguing that the benefits of the proposed acquisition outweigh the detriments.

## Our framework

10. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines and

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<sup>3</sup> A third party, Medismart, also undertakes treatment of medical and quarantine waste in the North Island.

<sup>4</sup> [Tennex Capital Limited and San-i-pak Limited \[2016\] NZCC 5](#) (29 February 2016).

<sup>5</sup> Ibid at [54].

Authorisation Guidelines.<sup>6</sup> As required by the Commerce Act 1986, we assess authorisation applications using a two-step process.

11. For acquisitions, when we receive an application for authorisation we must first assess whether the acquisition would be likely to substantially lessen competition in a market. If we are satisfied that the acquisition would not be likely to have that effect, then we would clear the acquisition.
12. 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).<sup>7</sup> This allows us to assess the degree by which the proposed acquisition might lessen competition. When making this assessment, we consider, among other matters:
  - 12.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
  - 12.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
  - 12.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.
13. For authorisation applications, if we are not satisfied that the lessening is not likely to be substantial and cannot grant clearance, we then apply the public benefit test to determine whether to authorise the acquisition.
14. We must authorise an acquisition where we are satisfied that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted. The public benefit test requires us to balance the detriments that may result from the proposed acquisition against the public benefits that the acquisition may bring about.
15. In our assessment we regard a public benefit as any gain to the public of New Zealand that would result from the proposed acquisition. We also take into account any costs that might be incurred in achieving those benefits. The benefits that we take into account must result from the acquisition and we do not take into account any benefits that would occur without the acquisition. For example, we may consider a reduction in operating costs resulting from the removal of duplication as a benefit, so long as this reduction is a direct result of the acquisition.

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<sup>6</sup> Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2013) and *Authorisation Guidelines* (July 2013). Available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz).

<sup>7</sup> *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

16. The Commission is required to consider all detriments that it is satisfied would likely arise from the proposed acquisition. The detriments will frequently include, but are not limited to, economic detriments such as allocative efficiency detriments (welfare losses from increased prices/reduced quality), productive efficiency losses (higher costs over time), and dynamic efficiency losses (reduced incentive to innovate).

### **Market definition**

17. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed 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.<sup>8</sup>
18. Consistent with past decisions of the Commission, we propose to assess the impact of the proposed acquisition in the markets for:
- 18.1 the collection of medical and quarantine waste in the South Island; and
- 18.2 the treatment and disposal of medical and quarantine waste in the South Island.

### **Without the acquisition**

19. We will consider what the parties would do if the proposed acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding a different buyer for the medical and quarantine waste collection and treatment assets of San-i-pak.

### **Preliminary issues**

#### **Whether the acquisition would be likely to substantially lessen competition**

20. The Commission has previously (as part of its 2016 clearance decision) investigated and reached a view on whether the acquisition would be likely to substantially lessen competition in the relevant markets. However, we will re-investigate whether the proposed acquisition would be likely to substantially lessen competition as part of our consideration of Tennex's application for authorisation. In doing so, we will consider:
- 20.1 whether there have been any material changes in the market since 2016;
- 20.2 the extent to which other suppliers currently compete with the merging parties in the collection of medical and quarantine waste in the South Island, and whether they would effectively constrain the merged entity from raising its prices above the competitive level, or reducing the quality of its services;

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<sup>8</sup> Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

- 20.3 how easily new suppliers could enter, and whether entry by new suppliers offering medical and quarantine waste treatment services in the South Island is likely, of sufficient extent and would occur in a timely fashion to prevent a substantial lessening of competition; and
- 20.4 whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

### **Whether the benefits of the acquisition are likely to outweigh the detriments**

#### *Tennex's submissions*

- 21. Tennex has submitted that the proposed acquisition generates a substantial net benefit, which outweighs considerably the detriments from the acquisition.<sup>9</sup>
- 22. In terms of the benefits of the acquisition, Tennex submitted that these include:
  - 22.1 San-i-pak avoiding capital costs relating to its operations;
  - 22.2 ongoing operating cost savings from consolidating IWL's and San-i-pak's operations in Christchurch;
  - 22.3 IWL being able to re-deploy San-i-pak's plant in parts of its operations;
  - 22.4 the medical and quarantine waste volumes currently treated by San-i-pak being treated more robustly by IWL post-acquisition, using superior risk management practices;
  - 22.5 fewer emissions, with San-i-pak's treatment plant no longer discharging odours directly to the atmosphere; and
  - 22.6 reduced carbon emissions as a result of the merged entity being able to more efficiently collect all of the medical and quarantine waste currently collected by IWL and San-i-pak.
- 23. In terms of detriments, Tennex has submitted that these include:
  - 23.1 allocative efficiency losses (ie, output reductions caused by post-acquisition price increases);
  - 23.2 productive efficiency losses;
  - 23.3 dynamic efficiency losses; and
  - 23.4 a reduction in security of supply in Christchurch, as a result of the number of medical and quarantine waste treatment plants reducing from two to one.

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<sup>9</sup> <https://comcom.govt.nz/case-register/case-register-entries/tennex-capital-limited-san-i-pak-limited>.

*What we will consider*

24. We will investigate and assess whether the benefits of the proposed acquisition are likely to outweigh the detriments.
25. In assessing detriments, a key part of our investigation will be to understand the likely magnitude of harm that would result from the acquisition. In assessing detriments we will specifically consider:
  - 25.1 the level of price increases (or reductions in service quality) that are likely to occur post-acquisition and how customers are likely to respond to price increases (or reductions in service quality);<sup>10</sup>
  - 25.2 the degree to which the acquisition would reduce the ability and/or incentive of IWL to minimise the costs involved in it collecting, treating and disposing of medical and quarantine waste in the South Island;
  - 25.3 the degree to which the acquisition would reduce the extent of innovation in the relevant markets in the future; and
  - 25.4 any other category of detriments we identify.
26. Our assessment of the public benefits that the acquisition may bring about will consider the potential improvements in productive efficiency and dynamic efficiency, as well as other benefits. In assessing public benefits, we will specifically consider (for each benefit claimed by Tennex):
  - 26.1 whether there is a clear link between the proposed acquisition and the benefit (ie, is the benefit a direct result of the acquisition, or might it occur both with and without the acquisition);
  - 26.2 whether the benefit is one-off or recurring;
  - 26.3 how and when the benefit will arise;
  - 26.4 the likelihood and magnitude of the benefit; and
  - 26.5 any costs that might be incurred in achieving the benefit.

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<sup>10</sup> In considering how customers may respond to price increases (or reductions in service quality), we will consider whether customers could take steps to reduce their volumes of medical and quarantine waste and what the next best options are for customers, other than having waste treated by IWL and San-i-pak.

## Next steps in our investigation

27. The Commission is currently scheduled to make a decision on whether or not to give authorisation to the proposed acquisition by **11 December 2018**. However, this date may change as our investigation progresses.<sup>11</sup> In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
28. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

## Making a submission

29. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference "Tennex/San-i-pak" 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 on **Friday, 12 October 2018**.
30. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
31. 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 in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

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<sup>11</sup> The Commission maintains a case register on our website where we update any changes to our deadlines and provide relevant documents. See <https://comcom.govt.nz/case-register/case-register-entries/tennex-capital-limited-san-i-pak-limited>.