



COMMERCE COMMISSION

Decision No. 452

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

PALOMA INDUSTRIES LIMITED

and

SOUTHCORP WATER HEATERS NEW ZEALAND LIMITED

- The Commission:** Paula Rebstock
- Summary of Application:** Paloma Industries Limited, through its wholly owned subsidiary NZ Water Heater Company Limited, wishes to acquire 100% of the water heater and heating elements business of Southcorp Water Heaters New Zealand Limited.
- 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:** 18 January 2002

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THE PROPOSAL

1. Clearance is sought for the proposed acquisition by Paloma Industries Limited (Paloma), through its wholly owned subsidiary NZ Water Heater Company Limited, of 100% of the water heaters and heating elements business of Southcorp Water Heaters New Zealand Limited.
2. Southcorp Water Heaters New Zealand Limited (SWH) is part of the Southcorp Water Heaters Group based in Australia. The ultimate holding company of the Southcorp Water Heaters Group is Southcorp Limited, a major company listed on the Australian stock exchange.

THE PROCEDURES

3. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 18 January 2002.
4. In its application, Paloma sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
5. The Commission's determination is based on an investigation conducted by staff.
6. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.¹

THE PARTIES

Paloma Industries Limited (Paloma)

7. Paloma Industries Limited (a privately held Japanese company) is part of the Paloma group based in Japan. The ultimate holding company of Paloma is Paloma Co. Ltd, (also privately held Japanese company), which produces gas appliances, including water heaters.
8. Paloma Co. Ltd (together with its subsidiaries) manufactures and sells water heaters in Japan.

¹ Commerce Commission, *Practice Note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

9. Paloma products are sold throughout Asia, and in Australia and New Zealand. Paloma Co. Ltd also owns Rheem Manufacturing Company, which is a North American producer of water heaters under the “Rheem” and “Ruud” brands. Raypak Australia Pty Ltd (Raypak) is a subsidiary of Rheem Manufacturing Company. Raypak supplies commercial hot water heaters and boilers to both New Zealand and Australia.
10. The details of the remainder of the Paloma Group are not relevant to this application.

Southcorp Water Heaters New Zealand Limited

11. Southcorp Water Heaters NZ Limited is part of the Southcorp Water Heaters Group based in Australia. The ultimate holding company of the Southcorp Water Heaters Group is Southcorp Limited, a major company listed on the Australian Stock Exchange.
12. The Australasian Water Heaters business unit is part of the Southcorp Water Heaters Group. The Southcorp Water Heaters group is divided up into a number of business units. The Australian part of this business unit manufactures and sells water heaters in Australia under the “Rheem” and “Vulcan” brands. It supplies approximately [] of Australia’s total annual water heater demand.

Other Water Heating Companies

13. The following companies compete with Southcorp in the water heater market.

Rinnai New Zealand Limited (Rinnai)

14. Rinnai imports and manufactures a range of gas heating appliances, including the continuous flow system, Infinity. Rinnai is strong in the continuous flow range and was the first to introduce continuous flow systems to New Zealand in 1990. Rinnai is owned by the Rinnai Corporation of Japan. Its water heater division has an annual turnover of approximately [].

HJ Cooper Limited (HJ Cooper)

15. HJ Cooper manufactures and sells low pressure storage and water boiling units from its Auckland plant and has an annual turnover of approximately [].

Peter Cocks Limited (Peter Cocks)

16. Peter Cocks is a privately owned manufacturer of low pressure systems based in Christchurch. Peter Cocks has an annual turnover of approximately []. Peter Cocks’ main presence is in the South Island market for low pressure hot water heaters.

Multi Machinery Limited (Multi Machinery)

17. Multi Machinery also operates from Christchurch manufacturing low pressure storage water heaters. Multi Machinery has a turnover of [] per annum.

CJ Energy Services Limited

18. CJ Energy is an importer of a variety of heating products, including domestic hot water systems. CJ Energy sells low pressure, mains and gas hot water systems, including the Australian product, Dux. CJ Energy has an annual turnover of around [].

Other Participants

19. Numerous other small operators exist around the country producing low pressure electric hot water systems. No additional firms were identified as being present in the mains pressure or gas water heater ranges.

INDUSTRY BACKGROUND

20. Hot water heaters are employed for both domestic and industrial purposes. The most common type of water heater used in New Zealand is the low pressure electric heater. New Zealand has traditionally produced these heaters using material and ‘screw on element’ technology that is unique to the rest of the world. To date the industry has been characterised by low levels of technology and low cost structures.
21. The industry has a number of small manufacturers of the low pressure electric systems while the more expensive mains pressure and gas systems are only produced in New Zealand by Southcorp. Mains pressure, gas, and continuous flow systems are also imported by firms such as Rinnai, Dux, and Paloma. There are no importers of low pressure electric water heaters in the New Zealand market.
22. Industry standards for energy efficiency will be mandatory from 2003. These will have an impact on imported products entering the market as most international products do not comply with the new standard, which will be stricter than others internationally.

MARKET DEFINITION

23. 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.

24. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the ‘*ssnip* test’). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

25. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.
26. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:
- the goods or services supplied and purchased (the product dimension);
 - the level in the production or distribution chain (the functional level);
 - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
 - the temporal dimension of the market, if relevant (the timeframe).
27. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.
28. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.
29. The applicant submits that the market that will be affected by the proposed acquisition is:
- The market for the supply of storage water heaters to wholesalers.

Product Dimension

30. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.
31. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.² The Commission

² In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be

considers this to be a period of one year, which is the period customarily used internationally in applying the ‘ssnip’ test (see above) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

Demand-side and Supply-side substitution

32. 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.
33. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a snip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a snip would be profitable.
34. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.
35. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.
36. The Commission considers supply side substitution in the market relevant to the application to be weak.
37. It is difficult to switch production from one type of heater to another. For example, to switch from electric low pressure water heaters to gas heaters or mains pressure heaters requires a substantial capital and technological investment.
38. The Commission considers demand side substitution to be strong in the markets relevant to the application.

strong substitution, at least in the long run, if given a sufficient price incentive”. See also *News Limited v Australian Rugby Football League Limited & Ors* (1996) ATPR at 41,687, where Burchett J stated: “Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation.” Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

39. Although hot water systems are differentiated in terms of the technology they employ, and the method of delivering hot water, the end product from all water heating systems is hot water. For this reason, the various forms of heaters are substitutable for each other from a demand side perspective. Consumers are very price sensitive to the cost of installation with jobs being won or lost on the cost of purchasing and installing the heating unit, regardless of what type of unit is employed.
40. The Commission therefore concludes that for the purpose of assessing the competition implication of the proposed acquisition, the appropriate product market is the market for:
- The market for the supply of storage water heaters.

Geographic Extent

41. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a snip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a snip.
42. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.
43. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.
44. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.
45. The applicant submitted that the market for the supply of storage water heaters is New Zealand wide.
46. The Commission considers the market supplied by the parties of the acquisition to be New Zealand wide. Although there are some smaller firms that supply merchants primarily in their geographic area, for example, the South Island, the market in which manufacturers operate can be considered to be New Zealand wide.

47. The Commission concludes that the geographic market is New Zealand.

Functional Level

48. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.³ Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

49. The applicant submits that the proposed acquisition affects the wholesale market for the supply of water heaters. SWH currently manufacture and import water heater units for supply to retailers and plumbing merchants. This market is also supplied by Paloma in the form of imports, which serve as a competitive constraint on domestic producers such as SWH.

50. The acquisition will not result in any integration between different functional levels, and other functional levels are unlikely to be affected by the acquisition given the choice of imports at the retail and wholesale level.

51. Therefore, the functional level considered for this market is:

- The supply of water storage heaters to wholesalers.

Conclusion on Market Definition

52. The Commission concludes that the relevant market is:

- The supply of water storage heaters to New Zealand wholesalers in New Zealand.

COMPETITION ANALYSIS

Substantially Lessening Competition

53. Section 47 of the Act prohibits particular business acquisitions. It provides that:

³ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: “If we ask what functional divisions are appropriate in any market definition exercise, the answer, ..., must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market.”

A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

54. Section 2(1A) provides that substantial means “real or of substance”. Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.⁴ What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.⁵

55. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.⁶

56. While the Act defines the words “substantial” and “lessening” individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.⁷

57. In interpreting the phrase “substantially lessening competition”, the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

58. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

⁴ *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

⁵ *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [] 1 All ER 289.

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

⁷ See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

59. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

60. The Commission uses a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios.
61. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.
62. If Paloma had not made the application to purchase SWH it can be assumed that Southcorp would still sell its water heater and elements business. In this case it may have been purchased by another water heater firm, or an unrelated company. However, this is a very uncertain scenario.
63. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should an acquisition not occur⁸. It is uncertain what changes, if any, there will be in the market if the proposed acquisition does not proceed. The Commission will therefore use the status quo, that is the ownership of Southcorp Water Heaters Limited by Southcorp Limited.

⁸ *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

Competition Analysis Principles

64. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.
65. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints in relation to existing competition.

ANALYSIS OF EXISTING COMPETITION

Introduction

66. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

67. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.
68. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure that yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors that lead to the other

different market share results are more appropriately considered elsewhere during the assessment of the acquisition.⁹

69. In determining market shares, the Commission will take into account the existing participants (including ‘near entrants’), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission’s ‘safe harbours’, an estimation of market shares, and an evaluation of existing competition in the market. Each of these is now considered in turn.

Existing Participants

70. Competing providers of water heaters in the New Zealand wholesale market include:

- New Zealand based manufactures of electric low pressure water heaters;
- Imported products, primarily in the mains pressure, gas, and continuous flow systems.

71. Water heaters are supplied to the New Zealand market by a variety of sources, including New Zealand manufacturers such as SWH, HJ Cooper, Peter Cocks, and Multi Machinery. SWH manufacture the well known Rheem brand. Imported products are supplied to the New Zealand market by firms such as Dux and Rinnai. Rinnai is in a strong position the continuous flow market. Competition is strongest in the market for low pressure electric heaters where there are numerous manufacturers in New Zealand. Since low pressure water heaters are substitutable for other models, they serve as competition for mains pressure, gas, and continuous flow models.

Inter-firm Relationships

72. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.

73. Various relationships currently exist between participants in the industry. [

].

74. [

].

⁹ For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

75. The information supplied by industry participants suggest that the relationships between competitors do not significantly impact on competition.

Safe Harbours

76. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or
- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

77. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

Market Shares

78. Table 1 outlines the characteristics of, and circulation numbers for, the relevant operators in the market.

TABLE 1

The New Zealand Water Heater Market

Name	Description of activities in NZ	Owned By	Estimated % of market sales
Southcorp Water Heaters NZ Limited	Manufacturer and supplier of electric and gas water heaters.	Southcorp Limited	[]
Rinnai New Zealand Limited	Importer of Rinnai instantaneous gas water heater and importer and manufacturer of gas heating appliances.	Rinnai Corporation (Japan)	[]
H J Cooper Ltd	Manufacturers of low-pressure storage water heaters and boiling units.	Private ownership	[]
Paloma	A small amount of Paloma product is currently imported into New Zealand	Private Ownership	[]
Peter Cocks	Manufacturer of low pressure storage water heaters	Private ownership	[]
Multi-Machinery	Manufacturer of low pressure storage water heaters	Private ownership	[]
Others - 3	Manufacturers of low pressure storage water heaters	Private ownership	[]

79. With a market share of [] Southcorp already has a market share that is greater than the safe harbour. The proposed acquisition will not have a large impact on the position of Southcorp as Paloma currently has a market share of [].

State of Existing Competition

80. While many industry participants noted the strong position of SWH and the Rheem brand in the market, all considered the wholesale market for the supply of water heaters to be competitive and supplied by a sufficient number of firms. No participants believed that this would change as a result of the acquisition.

81. As well as domestic competition from New Zealand manufacturers of low pressure systems, competition is also supplied by imported products other than Paloma's, including Rinnai, Bosche, and Dux. These firms all seek the same customer as Paloma, and this will not change should the proposed acquisition proceed.

Conclusion – Unilateral Market Power

82. Paloma will not gain unilateral market power by obtaining SWH due to existing competition that will continue to constrain the merged entity should the acquisition proceed.

Scope for the Exercise of Coordinated Market Power

Introduction

83. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.
84. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.
85. “Collusion” involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.
86. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column Table 2. The significance of these is explained more fully in the Commission’s *Practice Note 4*. The right-hand column of the table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the exploration market. A high proportion of ‘yes’ responses would suggest that the market was particularly favourable to ‘collusion’; a high proportion of ‘no’ responses the reverse.

TABLE 2**Testing the Potential for ‘Collusion’ in the Water Heaters Market**

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Moderate
Undifferentiated product/service	Limited differentiation
New entry slow	Yes, but expansion of current competitors is possible
Lack of fringe competitors	No
Price inelastic demand curve	No
Industry’s poor competition record	No
Presence of excess capacity	No
Presence of industry associations/fora	Yes

87. The assessment of the relevant conditions suggests that there are few characteristics in the market that are likely to be conducive to collusion. While seller concentration is high in the mains pressure, gas, and continuous flow segments of the market, there are numerous producers of low pressure electric systems that serve as a competitive constraint for these segments. The Commission considers that this, along with the presence of fringe competitors and the elasticity of demand, reduce the potential for collusion. This situation is unlikely to change as a result of the proposed acquisition.

Conclusion – Co-ordinated Market Power

88. The Commission concludes that the proposed acquisition would not materially enhance the likelihood of co-ordinated market power in the market for the supply of water heaters to wholesalers in New Zealand.

Conclusions – Existing Competition

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

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

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

OVERALL CONCLUSION

92. The Commission has considered the probable nature and extent of competition that would exist in the markets for the supply of water heaters to wholesalers in New Zealand. The Commission considers that the appropriate benchmark is the status quo, in which the market is characterised by effective competition from existing participants.
93. The Commission has considered the nature and extent of the contemplated lessening in terms of the competitive constraints that would exist following the merger from:
- existing competition; and
 - potential competition from entry.
94. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for the supply of water heaters wholesalers in New Zealand.

DETERMINATION ON NOTICE OF CLEARANCE

95. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Paloma Industries Limited of up to 100% of the assets and interests associated with Southcorp Water Heaters New Zealand Limited.

Dated this 18th Day of January 2002

Paula Rebstock
Deputy Chair