

Determination

B100 Limited and Realcold Limited [2015] NZCC 25

- The Commission:** Dr Mark Berry
Sue Begg
Anna Rawlings
- Summary of application:** B100 Limited, which owns Patton Limited and is a subsidiary of Beijer Ref AB, seeks clearance to acquire the business and assets of Realcold Limited.
- Determination:** Under s 66(3)(a) of the Commerce Act 1986 the Commerce Commission determines to give clearance to the proposed acquisition.
- Date of determination:** 6 October 2015

Confidential material in this report has been removed. Its location in the document is denoted by [].

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The proposed acquisition

1. B100 Limited, which owns Patton Limited (Patton), is a newly incorporated subsidiary of the Swedish refrigeration group Beijer Ref AB (Beijer). B100 Limited's application to the Commerce Commission for clearance to acquire the business and assets of Realcold Limited (Realcold) was registered on 12 August 2015.

The decision – clearance given

2. The Commission gives clearance to the proposed merger, as 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.

Our framework

3. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.¹

The substantial lessening of competition test

4. As required by the Commerce Act 1986 (the Act), we assess mergers using the substantial lessening of competition test.
5. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
6. We make a pragmatic and commercial assessment of what is likely to occur in the future with and without the acquisition based on the information we obtain through our investigation and taking into account factors including market growth and technological changes.
7. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),³ or reduce non-price factors such as quality or service below competitive levels.
8. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.
9. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³ Or below competitive levels in a merger between buyers.

define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, “as a matter of fact and commercial common sense”.⁴

When a lessening of competition is substantial

10. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.⁵ Some courts have used the word ‘material’ to describe a lessening of competition that is substantial.⁶
11. There is no bright line that separates a lessening of competition that is substantial from one that is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

When a substantial lessening of competition is likely

12. A substantial lessening of competition is ‘likely’ if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility, but does not mean that the effect needs to be more likely than not to occur.⁷

The clearance test

13. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.⁸ If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.⁹
14. The burden of proof lies with Beijer as the applicant to satisfy us on the balance of probabilities that the acquisition is not likely to have the effect of substantially lessening competition.¹⁰ The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence.¹¹

⁴ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁵ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁶ *Ibid* at [129].

⁷ *Ibid* at [111].

⁸ Commerce Act 1986, section 66(1).

⁹ In *Commerce Commission v Woolworths Limited* (CA), above n 2 at [98], the Court held that “the existence of a ‘doubt’ corresponds to a failure to exclude a real chance of a substantial lessening of competition”. However, the Court also indicated at [97] that we should make factual assessments using the balance of probabilities.

¹⁰ *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7] and *Commerce Commission v Woolworths Ltd* (CA) above n 2 at [97].

¹¹ *Commerce Commission v Woolworths Ltd* (CA) above n 2 at [101].

Key parties

Overview

15. Both Patton and Realcold are wholesale suppliers of commercial refrigeration and air conditioning equipment, components and refrigerants to trade customers in New Zealand.

Beijer

16. The acquiring entity, B100 Limited, is a newly incorporated subsidiary of the Swedish refrigeration group, Beijer. Beijer is one of the largest refrigeration wholesalers in the world.¹² In March 2015, Beijer entered the New Zealand market with its acquisition of Patton Limited.¹³
17. Beijer operates in New Zealand under the Patton brand. Patton imports refrigeration and air conditioning equipment and componentry. On the refrigeration side it also designs and assembles unit coolers, condensers and condensing units under the Patton brand. Patton has assembly facilities in New Zealand, Australia and Thailand and nine branches in New Zealand.¹⁴ Last financial year, Patton had a turnover of \$[].

Realcold

18. Realcold also imports refrigeration and air conditioning equipment and componentry, and on the refrigeration side also assembles and markets unit coolers, condensing units and condensers under the Realcold brand. Realcold operates in New Zealand and Australia with nine branches in New Zealand.¹⁵ Realcold's turnover was \$[] last financial year.

Extent of overlap

19. Both Patton and Realcold supply to installers, servicers and technicians of refrigeration and air conditioning equipment.¹⁶ Neither party supplies directly to end customers such as domestic customers, commercial customers (eg, supermarkets) or industrial customers (eg, meat works, dairy farms). Neither firm is involved in the servicing of refrigeration or air conditioning equipment.

Other relevant parties

Competitors

20. There are other suppliers of refrigeration and air conditioning equipment in New Zealand. Those with product offerings closest to that of the parties' include:

¹² Application at 5 <http://www.comcom.govt.nz/dmsdocument/13528>

¹³ <http://www.coolingpost.com/features/the-rise-and-rise-of-beijer-ref/>

¹⁴ Auckland North Shore, Auckland Mt Wellington, Hamilton, Tauranga, Hastings, Palmerston North, Wellington, Nelson and Christchurch.

¹⁵ Auckland North Shore, Auckland (Penrose), Hamilton, Tauranga, Hastings, Palmerston North, Lower Hutt, Christchurch and Dunedin.

¹⁶ For the purposes of this document, 'installers' refers to firms who install, repair, service/maintain and provide technical advice on refrigeration and air conditioning equipment.

20.1 Heatcraft Pty (Heatcraft); and

20.2 Refrigeration Specialities (RefSpecs).

21. Some further suppliers focus on one or two of the product offerings supplied by the parties as outlined below, (such as refrigerants and/or air conditioning components).

Heatcraft

22. The closest competitor to Patton and Realcold is Heatcraft, both in terms of product coverage and size. Heatcraft is a US based firm and has been in New Zealand since 1995. Like Patton and Realcold, Heatcraft supplies to installers. About 40% of its business is focused on the supply of new refrigeration and air conditioning equipment while the rest is focused on the supply of refrigeration and air conditioning components and refrigerants. Heatcraft has an annual turnover of around \$[].¹⁷
23. Heatcraft has eight branches across New Zealand.¹⁸ It is not present in Nelson or in Auckland's North Shore.¹⁹

Refrigeration Specialists

24. There is at least one other competitor to the proposed merged entity. Refrigeration Specialities (RefSpecs) was started by an ex-Realcold employee five years ago and is based in Auckland, Penrose with a sales representative based out of Christchurch to service the South Island. While RefSpecs has a similar product coverage to Patton and Realcold, it is smaller with a turnover of around \$[] for the last financial year.²⁰

Other competitors

25. In the refrigeration equipment and components area, Bitzer, a large German based manufacturer, is a distributor of its own brand of compressors, condensers and components. It operates in New Zealand through its Australian office.
26. Cooling Equipment/Compnex is a specialist supplier of refrigeration equipment such as coil plants and cooling coils, which are sold to installers for end customers such as supermarkets. They have a branch in Palmerston North and their turnover is around \$[] a year.²¹
27. Having moved away from the refrigeration equipment business due to the need to provide technical support, [] is focused on growing its refrigerants and

¹⁷ Interview with []

¹⁸ Auckland, Hamilton, Hastings, Lower Hutt, Palmerston North, Tauranga, Christchurch and Dunedin.

¹⁹ We have considered these two areas in detail using information about the customer reach of Heatcraft's existing branch network in the geographical overlap section.

²⁰ Interview with []

²¹ Interview with [] 10 September 2015.

refrigeration components side of the business. They have [] locations in New Zealand: [].²²

28. In terms of refrigerants, other suppliers include:
- 28.1 BOC Limited (BOC), a major chemicals manufacturer supplying a range of gases, including refrigerants from its 19 locations across New Zealand;
 - 28.2 Axieo Specialities (Axieo),²³ a large Australian based manufacturer of chemicals and polymers including refrigerants; and
 - 28.3 Cooling Supplies – a Rangiora based business supplying refrigerants, refrigeration lubricants and fan motors.
29. Patton and Realcold supply high wall split air conditioning units (also known as heat pumps) from Mitsubishi Heavy Industries, Mitsubishi Electric and Gree. Apart from Gree which is exclusively distributed by Realcold, both Patton and Realcold compete with other suppliers of these brands of air conditioning units. Other suppliers include specialist air conditioning installers such as Heat Pump Guys and Air Con New Zealand and retailers such as Noel Leeming.²⁴ In addition, the air conditioning brands that Patton and Realcold supply also compete with other brands of air conditioning units such as Fujitsu, Panasonic, Toshiba, Samsung, Hitachi and Daikin.
30. There are a number of specialist air conditioning components suppliers including Holyoake Air Management Solutions, Smooth-Air and AHI Carrier/Totaline.

Customers

31. Installers vary in terms of size and geographical reach and tend to cover both the refrigeration and air conditioning side. There are a number of national providers such as [], which have branches across New Zealand. There are also a number of regional installers, for example, []. Finally, there are local installers who cover a smaller geographical area such as [].
32. We spoke to 12 installers in total: four of which have a national presence; three of which are regionally focused; and five of which are locally based.

²² Interview with [] 2 September 2015.

²³ Formerly Nuplex Specialities.

²⁴ In these cases, the domestic end customer may pre-purchase the air conditioning unit and then get an installer to fit it.

Industry background

Refrigeration

33. Beijer sees a significant need for efficient refrigeration plants in New Zealand due to large food exporting industry and the growth in tourism.²⁵ In Australia, growth in the demand for commercial refrigeration driven by the increase in supermarkets, restaurants, and food manufacturing industries is likely to increase the demand for commercial refrigeration,²⁶ and a similar trend appears to be occurring in New Zealand.²⁷
34. Regulatory changes in New Zealand suggest that the air conditioning and refrigeration industry will move away from refrigeration systems that are ozone depleting, namely hydrochlorofluorocarbons (HCFCs).²⁸ By 2020 it is expected that common refrigerants in use today will have been phased out.²⁹ We understand that there is already growing demand for CO₂ and ammonia refrigerant compatible refrigeration systems that are also more energy efficient.^{30 31} This provides an incentive for end customers to upgrade existing refrigeration equipment, particularly due to the energy efficiency gains from new CO₂ compatible refrigeration systems.³²
35. On refrigeration components, the expansion in the use of electronic systems rather than mechanical systems means that if there is a fault in a mechanical system, it may be more cost effective for end customers to purchase new equipment; rather than repairing the existing equipment by replacing components, particularly if the equipment is towards the end of its life cycle of 10-15 years. This trend potentially creates additional demand for equipment rather than components.³³

Air conditioning

36. Air conditioning covers domestic small scale, on the wall heat pumps through to Heating Ventilation and Air Conditioning (HVAC) systems in domestic homes, as well as large scale ducted systems for commercial offices or large buildings. Air conditioning products consist of both the imported air conditioning units and the componentry, such as universal ducts, grilles and brand specific replacement parts. Components are both manufactured in New Zealand and imported from overseas.³⁴
37. Air conditioning will also be affected by the same regulatory changes facing refrigeration³⁵ - see above paragraph 34.

²⁵ Application at 5 <http://www.comcom.govt.nz/dmsdocument/13528>

²⁶ IBIS World – Commercial Refrigerator Manufacturing in Australia July 2015.

²⁷ Information submitted by []

²⁸ <http://www.mfe.govt.nz/node/20991>

²⁹ ibid.

³⁰ Interview with [] 15 September 2015.

³¹ Interview with [] 8 September 2015.

³² Information []

³³ Interview with [] 14 September 2015.

³⁴ Interview with [] 2 September 2015.

³⁵ Interview with [] 23 September 2015.

With and without scenarios

38. To assess whether competition is likely to be substantially lessened in any market, we compare the likely state of competition with the acquisition to the likely state of competition without the acquisition.³⁶

With the acquisition

39. With the acquisition, Beijer would own both Patton and Realcold. []³⁷

Without the acquisition

40. We have analysed the proposed acquisition based on a without the acquisition scenario of the status quo or a sale to a third party.
41. Beijer submitted that without the acquisition Realcold would continue to operate independently [].
42. Realcold has submitted that:³⁸
- 42.1 [];
- 42.2 [];
- 42.3 []; and
- 42.4 [].
43. []³⁹
[]
[]⁴⁰
[]⁴¹
44. We have compared the acquisition against the without the acquisition scenario of status quo or a sale to a third party on the basis that it is the most conservative. Doing so means our analysis is based on a worst case scenario, in the sense that it is the scenario that would lead to the greatest competition concerns. If the merger is

³⁶ *Mergers and Acquisitions Guidelines* above n 1 at [2.29]; *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³⁷ []

³⁸ Information submitted by Realcold []

³⁹ []

⁴⁰ []

⁴¹ []

unlikely to substantially lessen competition compared to the worst case scenario, then it is unlikely to substantially lessen competition when compared to any other likely scenario.

Market definition

Overall market definition

45. For the reasons outlined below, we consider that the relevant markets for consideration are the wholesale supply of:
 - 45.1 refrigeration equipment in New Zealand;
 - 45.2 refrigerants in regions across New Zealand;
 - 45.3 refrigeration components in regions across New Zealand;
 - 45.4 air conditioning units in regions across New Zealand; and
 - 45.5 air conditioning components in New Zealand.

46. Where we find that there is no substantial lessening of competition at the regional level, we consider that there would be no substantial lessening of competition at the national level.

Our approach to market definition

47. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.

48. We define markets in the way that best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products which fall outside the market but which still impose some degree of competitive constraint on the merged entity.

The applicant's view of the relevant markets

49. Beijer submitted that the relevant markets where the parties overlap are in the national market for the wholesale supply of:
 - 49.1 refrigeration equipment⁴²;

⁴² On refrigeration equipment, Beijer submitted that both parties undertake the assembly of refrigeration equipment, marketed under their own brands (pre-assembled) and also custom make refrigeration equipment to suit end customer specific requirements. As suppliers can readily switch between supplying pre-assembled and custom made refrigeration equipment, we agree with the applicant that a single refrigeration equipment market would be appropriate when analysing the proposed merger.

- 49.2 refrigerants;
- 49.3 refrigeration components;
- 49.4 air conditioning units; and
- 49.5 air conditioning components.

50. While we agree with the applicant's proposed product categories, in the next section we assess whether a national market is appropriate for all the above product categories, as submitted by the applicant.

Geographical overlap of parties and main competitors

51. In order to assess whether a national market is appropriate in all the product categories defined, we have analysed the geographical overlap of the parties and its main competitors namely Heatcraft and RefSpecs.
52. Table 1 below shows the geographical overlap of branches and sales representatives between Patton, Realcold, Heatcraft and RefSpecs.

Table 1: Branch locations of Patton, Realcold, Heatcraft and RefSpecs, 2015

Branch	Patton	Realcold	Heatcraft	RefSpecs
Auckland - South (Penrose)	Branch	Branch	Branch	Branch
Auckland - North Shore	Branch	Branch	[]	[]
Hamilton	Branch	Branch	Branch	[]
Wellington	Branch	Branch	Branch	[]
Palmerston North	Branch	Branch	Branch	[]
Tauranga	Branch	Branch	Branch	[]
Hawkes Bay/Napier	Branch	Branch	Branch	[]
Christchurch	Branch	Branch	Branch	[]
Nelson	Branch	[]	[]	[]
Dunedin	[]	Branch	Branch	[]
Whangarei	[]	[]	[]	[]

53. We understand that while Realcold's Whangarei branch closed in 2014, []⁴³ Furthermore, []

54. With respect to coverage in the South Island, information from the parties suggests that:

⁴³ Interview with [] 20 August 2015.

54.1 [

54.2

54.3

54.4

54.5

54.6]

Geographic market definition

Refrigeration equipment

55. A national market for refrigeration equipment is supported by the approach of installers to seek quotes on equipment from a range of equipment suppliers regardless of the location of the installation relative to the location of the supplier's warehouse.⁴⁴ This form of procurement is allowed for by the long lead times on projects.

Refrigeration components

56. The supply of refrigeration components is time critical to avoid spoilage. An installer's ability to repair refrigeration equipment quickly is important to the end customer. Installers operate 24/7 and often have response times of between one to three hours.⁴⁵
57. Installers who are either based in more rural areas such as [], [] or installers who have more rural customers such as [] carry more components either at their offices or on their vehicles to overcome not having a branch nearby. If these installers require a specific component, they source the component from the cheapest or nearest provider, depending on their end customer preference, and get the component couriered to them or the end customer.
58. Five of the 12 installers we spoke to are able to or already meet their requirements for refrigeration components supply by pre-purchasing components.⁴⁶ Holding inventory in this way allows these installers to purchase components on a national basis.

⁴⁴ Interview with [] 8 September 2015; interview with [] 23 September 2015.

⁴⁵ For example [].

⁴⁶ [].

59. Installers with branches of Patton and Realcold nearby, particularly national and regional installers,⁴⁷ use the branch network frequently. This is mainly to free up cash flow by not holding components.⁴⁸
60. However, [], a national installer [] did not consider geographical outlets to be important as they purchase consignment stock based on price and availability from all four main competitors (Patton, Realcold, Heatcraft and RefSpecs) which is then couriered to their [] locations across New Zealand.⁴⁹
61. We note that installers who currently do not hold their own stock would need to alter their business model and invest working capital in holding stock, with the risk of stock items becoming obsolete or depreciating, if they did not want to use the branch network. While there is evidence to suggest that the relevant geographic market for the supply of refrigeration components may be national due to installers' ability to hold their own stock, for the purposes of this clearance we take a conservative approach and define the market for refrigeration components regionally. However, we consider whether installers holding stock may be a source of discipline on the distribution of refrigeration components when considering barriers to entry.

Refrigerants

62. Refrigerants are used in new equipment and in repairs. [] estimates that 40-50% of its sales for refrigerant are for individual canisters.⁵⁰ This is supported by at least one of the installers we spoke to [].⁵¹ Others however, tend to shop around and stock up on refrigerant based on price which they then store at their offices, []⁵²
63. Similarly to refrigeration components, we found evidence that at least two national installers, [] hold pre-purchased refrigerant at local branches mainly to save on storage costs. Therefore, given the use of local branches to store and hold refrigerants, we have taken a conservative view and have defined the market for refrigerants on a region-by-region basis.

Air conditioning units

64. As with refrigeration equipment, the installation of air conditioning units is subject to long project lead times and so installers seek quotes from a range of suppliers

⁴⁷ [].

⁴⁸ Interview with [] 14 September 2015.

⁴⁹ Interview with [] 9 September 2015.

⁵⁰ Information submitted by [] 2 September 2015.

⁵¹ Interview with [] 6 October 2015.

⁵² Interview with [] 23 September; interview with [] 24 September; interview with [] 24 September 2015.

regardless of the location of the installation or installer's office.⁵³ This supports a national approach to defining the market for air conditioning units.

65. There are many distributors of the four main brands (Mitsubishi, Fujitsu, Panasonic and Daiken), that amount to around 75-80% of the market⁵⁴. Units can be sourced through exclusive distributors of the various brands such as specialist air conditioning companies with locations across New Zealand, such as Air Con New Zealand, or distributed at the retail level through stores such as Noel Leeming, which have geographical coverage across New Zealand.⁵⁵ Given the distribution of these stores across the country, we take a conservative approach and define the market as regional.

Air conditioning components

66. Our understanding from air conditioning and refrigeration component suppliers is that repairs in air conditioning are not as time critical as in refrigeration.⁵⁶ This suggests that the ability to source components from a branch network swiftly is likely to be less important. Furthermore, air conditioning components are often used in the installation of new air conditioning units and therefore subject to long lead times and able to be sourced from locations that may not be near to the installer.⁵⁷ These characteristics of air conditioning components suggest that a national market is the appropriate geographical focus.

How the acquisition could substantially lessen competition

67. When a firm merges with a competitor that would otherwise provide a competitive constraint, the loss of that constraint may give the merged entity the market power to substantially increase prices or decrease quality, range, innovation efforts or service levels to the purchasers of that product.
68. A substantial lessening of competition may occur if a merger is likely to increase the ability of the merged entity and its rivals to coordinate their behaviour.

Horizontal unilateral effects – Refrigeration

69. The ability of the proposed merged entity to increase prices post-merger increases if:
- 69.1 refrigeration equipment supplied by the merging parties are close substitutes, with no other good alternatives;
 - 69.2 the supply of components and refrigerants is time critical and there are no alternative effective suppliers to the branch network provided by the merging parties entity; and

⁵³ Interview with [] 24 September 2015.

⁵⁴ Interview with [] 11 September 2015.

⁵⁵ Interview with [] 11 September 2015.

⁵⁶ Interview with [] 2 September 2015.

⁵⁷ Interview with [] 24 September 2015.

- 69.3 the supply of components is tied to existing refrigeration equipment either due to brand specificity and/or installer preference for like-for-like, with no other effective substitutes.

Horizontal unilateral effects – Air conditioning

70. The ability of the proposed merged entity to increase prices post-merger increases if:
- 70.1 air conditioning units supplied by the merging parties are close substitutes, with no other good alternatives;
 - 70.2 the supply of components is time critical and there are no alternative effective suppliers to the branch network provided by the merging parties; and
 - 70.3 the supply of components is tied to existing refrigeration equipment either due to brand specificity and/or installer preference like-for-like, with no other effective substitutes.

Coordinated effects

71. Given the industry is relatively close and well networked through industry events, this may allow for the proposed merged entity and its rivals to coordinate behaviour,⁵⁸ particularly if Beijer's international agreements with New Zealand rivals are used in New Zealand to coordinate behaviour.⁵⁹

Competition analysis

72. In general, the more closely substitutable two products are, the closer the competition and the greater the competitive constraint between the products.
73. We have assessed the extent of competition between the merging parties, as well as with remaining competitors, in each of the product categories by considering existing competition, potential competition, barriers to entry/expansion and countervailing power of customers.

Existing competition

Refrigeration equipment

74. There are six suppliers in the market, with Patton and Realcold each accounting for [] and [] of the market. Heatcraft accounts for [] of the market, RefSpecs [], with others such as Cooling Supplies and Bitzer amounting to [].⁶⁰
75. As the installation of refrigeration equipment tends to have long lead times compared with the repair of refrigeration equipment, all the installers we spoke to

⁵⁸ Information submitted by [] on 8 September 2015 at 5.

⁵⁹ For example, Beijer has rights to market and sell AHI Carrier's brand Totaline in some European countries. See <http://www.beijerref.com/en/Company/About-Beijer-Ref/Brands> for further detail.

⁶⁰ Using information submitted in the Application and the Commission's own estimates using information from competitors. These percentages do not include installers self-supplying refrigeration equipment through direct importation.

tender across all suppliers.⁶¹ This suggests that competitors to the proposed merged entity are well placed to meet installers' supply needs for refrigeration equipment. Looking forward, given regulatory changes and the move to natural refrigerants such as CO₂, currently in New Zealand, it is noted that currently Patton and Realcold supply no or very little CO₂ compatible refrigeration equipment.⁶²

[]
63

76. Given that installers tender for refrigeration equipment across all key competitors in this product market, coupled with the ability of installers to self-supply through imports,⁶⁴ we consider that existing competition sufficiently constrains the proposed merged entity to prevent it from raising the prices of refrigeration equipment.

Refrigerants

77. In addition to Patton, Realcold, Heatcraft and RefSpecs, refrigerants are also purchased by installers from BOC, Axieo and Cooling Supplies. BOC through their 19 locations of Gas and Gear around the country, supply a range of gases including refrigerant. Axieo is a major chemicals manufacturer supplying refrigerants in New Zealand through its Auckland head office.

[]
65

78. From discussions with installers, there is frequent switching in the purchase of refrigerants across all of these suppliers depending on the discounts and rebates available.⁶⁶

79. For example, [], a national installer, has recently switched from [] to [] to take advantage of cheaper refrigerant and the ability to store refrigerant at []. [] indicated that they monitor prices across all suppliers, seek out quotes when they want to bulk buy, and would switch again depending on the deal available.⁶⁷

80. [] another national installer purchases refrigerant on an on-going basis from [] who has [] New Zealand. This allows [] to purchase refrigerant as and when required. It also bulk purchases refrigerant from [] and holds refrigerant as stock.⁶⁸ [], another national installer, currently bulk buys refrigerant from [].⁶⁹

⁶¹ For example [].

⁶² Information submitted by [] 8 September 2015.

⁶³ Interview with [] 15 September 2015.

⁶⁴ Interview with [] 8 September 2015; interview with [] 9 September 2015; interview with [] 14 September 2015.

⁶⁵ Interview with [] 21 September 2015.

⁶⁶ Interview with [] 23 September 2015.

⁶⁷ Interview with [] 14 September 2015.

⁶⁸ Interview with [] 8 September 2015.

⁶⁹ Interview with [] 9 September 2015.

81. Regional and local installers also indicated that they monitor prices and switch often. They are more likely to bulk buy refrigerant and hold as stock than the national installers such as [].⁷⁰ Given the practice of regional and local installers to bulk buy and store refrigerant, and the ability of [] to supply refrigerant on an on-going basis in order to service national installers' preferences, we do not consider that there are likely to be adverse impacts on competition from the proposed merger in the refrigerants market.

Refrigeration components

82. There are three areas of potential concern in regard to refrigeration components:
- 82.1 a lessening of competition, in particular branded products, that results from a preference for like-for-like replacement components;
 - 82.2 regional non-price effects in regards to a decrease in stock availability, particularly of non-Patton brands; and
 - 82.3 regional price effects.
83. In regard to the first of these concerns, we understand that there may be a preference for like-for-like replacement for components when repairs are done.⁷¹ This may stem from end customers' preferences such as supermarkets specifying replacement components, installers' preferences to replace a component with the same replacement, or a technical need. For example, we understand that both Patton and Realcold supply Frascold compressors and Emerson/Copeland compressors.⁷²
84. Information [], suggests that "most major manufacturers supply at least two distributors in each geographical region in order to ensure competitive market pricing".⁷³ This indicates that if the merger proceeds, suppliers to Patton and Realcold may re-visit their current relationships with a view to adding another distributor to ensure competitive market pricing. For example, we note that Heatcraft was the sole distributor of Danfoss products up until February 2014, at which time Patton also became a distributor for the Danfoss brand.⁷⁴
85. The second concern about a decrease in stock availability is also related to the concern about reduced brand competition. Specifically, [] was concerned that the proposed merged entity may not provide sufficient support in terms of stock availability to existing brands which may be phased out in preference for own

⁷⁰ Interview with [] 14 September 2015; interview with [] 24 September 2015; interview with [] 23 September 2015; interview with [] 24 September 2015.

⁷¹ Interview with [] 14 September; interview with [] 8 September 2015.

⁷² <http://www.pattonnz.com/about-suppliers>; <http://realcold.co.nz/products/product-brands/>

⁷³ Information submitted by []

⁷⁴ For further detail see: www.pattonnz.com/pdf/otherNews/Danfoss_Press_Release_Feb_2014.pdf

branded componentry such as Patton.⁷⁵ This concern was also echoed by local installers such as [] and [].⁷⁶

86. Due to the life cycle of fridges, we expect that if certain branded components either become too expensive or sourcing them becomes difficult, then installers and end customers may opt to update their refrigeration equipment to a brand for which there are more competitive alternatives for the components.
87. As refrigeration equipment is not considered likely to be adversely affected by the merger, should prices of particular brands of components increase or become less available, we expect that installers and end customers would switch to equipment for which there are good competitive options for the associated components. The risk of this type of longer term switching provides some constraint on the proposed merged entity from increasing prices or reducing the supply of refrigeration components. The phasing out of ozone depleting refrigerants, (HCFCs), and shift to natural refrigerants, such as CO₂, also accelerates the process of updating refrigeration equipment.⁷⁷ New refrigeration equipment is also likely to be more energy efficient,⁷⁸ thereby providing additional incentive for installers to update their equipment.
88. We note that the updating of refrigeration equipment coupled with manufacturers, such as Emerson/Copeland and Frascold, likely re-visit their existing distributor relationships (see above), provides additional discipline on the proposed merged entity so that it is incentivised to continue to stock existing brands.
89. In regard to the third concern, we take a regional approach to refrigeration components due to the time critical nature of having to source components and undertake repairs.
90. As indicated in Table 1 above, there are eight locations in which the merging parties both have branch outlets. Of these eight locations, there is only one in which Heatcraft does not also have a location. That is, Auckland – North Shore []. As such, of particular consideration is whether the merger would face little remaining competition in that location, a location from which installers located north into Northland are also typically serviced, or whether Heatcraft and RefSpecs, which have branches in Auckland-South, also compete.
91. []. We contacted installers in the North Shore and in Northland to understand the impact of the proposed merged entity in these regions.

⁷⁵ Interview with [] 9 September 2015.

⁷⁶ Interview with [] 23 September 2015; interview with [] 24 September 2015.

⁷⁷ See paragraph 33 for further detail.

⁷⁸ Information []

92. [] has accounts open with Patton, Realcold, Heatcraft, RefSpecs for refrigeration equipment and components, and purchases refrigerant from []. However, they tend to default to Realcold on the day-to-day components required, due to the branch being located on the North Shore.
93. As part of their forward planning, [] has considered increasing its stock of components if the Realcold branch was closed or prices became too high. Under this scenario, [] would look to increasing stock of components which would cost about \$[]. Its turnover is around \$[], so this would amount to less than 1% of its turnover being tied up in working capital.⁷⁹
94. [] also had accounts open with Patton, Realcold, Heatcraft and RefSpecs though tended to get supplies from Realcold due to their location being convenient. On refrigerants, [] are currently supplied by RefSpecs in South Auckland. They are prepared to travel to South Auckland due to the competitive pricing that RefSpecs offer. If the proposed merged entity were to raise prices and alternatives were available, the installer would travel or get supplies delivered from South Auckland, most probably from RefSpecs.⁸⁰
95. [] previously had access to Realcold products through Realcold's branch. Since the Realcold branch closed, [] has taken to carrying more stock of the value of around \$[]. The firm has a turnover of around \$[], so this amounts to 1.5% of its revenue being tied up in working capital. [], however, stated that other types of costs have also increased such as freight costs and search costs associated with sourcing components, and managing potential delays to the end customer.⁸¹
96. Other local installers based in Northland, [],⁸² and []⁸³ did not have concerns about the merger, their strategy being to switch [] We therefore consider that the proposed merged entity would continue to face competitive constraints on the North Shore and in Northland.
97. In regard to the other areas in which there would be horizontal aggregation at the branch level as result of the merger, we consider that Heatcraft would continue to provide an important competitive constraint, as would RefSpecs [] outlined in Table 1.
98. Also of consideration in this regard is the ability of installers to self-supply their componentry requirements in face of a price increase. While this technically constitutes entry into the market through self-supply and so not part of existing

⁷⁹ Interview with [] 23 September 2015.

⁸⁰ Interview with [] 6 October 2015.

⁸¹ Interview with [] 24 September 2015.

⁸² Interview with [] 23 September 2015.

⁸³ Interview with [] 24 September 2015.

competition, the ease with which installers can enter into such self-supply and its relative low cost, is considered in our assessment of existing competition for components.

99. In addition to the examples noted above in Northland, we spoke to installers in rural areas such as [] who are used to not having a branch network to access components. They did not raise any competition concerns and being so remote are accustomed to carrying more stock and working around having components couriered either the same day or next day.⁸⁴
100. Given the existence of Heatcraft in other areas, either through its branch network or through sales representatives, and that installers can carry more stock, we do not consider that there are likely to be adverse impacts on competition from the proposed merger in the refrigeration components market.

Air conditioning units

101. The main distributor of Mitsubishi Electric air conditioning units is BDT⁸⁵ which also supplies to Patton amongst other distributors throughout the country. The other brands of air conditioning units supplied by Patton and Realcold do not have as strong a brand reputation as Mitsubishi Electric.⁸⁶ Given that Mitsubishi Electric is not exclusive to the proposed merged entity and has to compete with other established air conditioning brands such as Fujitsu, Daikin and Rinnai, we consider that the existing competition provides sufficient constraint on the proposed merged entity.
102. As the installation of air conditioning units is project based with long lead times, even where installers may prefer a one stop shop close to their proximity, Heatcraft and air conditioning specialists such as Heat Pump Guys who have locations across New Zealand are likely to provide sufficient competitive constraint to the proposed merged entity.

Air conditioning components

103. Air conditioning components tend to be brand specific and installers are required to source these products from the relevant brand-authorized dealer.⁸⁷ As such the competitive constraint provided in the supply of air conditioning units would also occur in the supply of air conditioning components. We understand that there are also universal components, where competitors such as AHI Carrier/Totaline compete alongside Heatcraft, Patton and Realcold.
104. A concern raised by [] was that the buying power the proposed merged entity could leverage may close off access to certain brands of refrigeration components and air conditioning components and units where they and the proposed merged entity share the same supplier.

⁸⁴ Interview with [] 14 September 2015.

⁸⁵ Interview with [] 11 September 2015.

⁸⁶ Interview with [] 11 September 2015.

⁸⁷ Submission received from [] 11 September 2015.

[]⁸⁸
[]⁸⁹

- 105. In addition, at least one supplier of universal components in New Zealand we spoke to operates as both a supplier to Patton and Realcold and competitor by directly supplying to installers such as []⁹⁰
- 106. These factors suggest that the existing competition in the air conditioning components area would provide sufficient competitive constraint to the proposed merged entity.

Potential competition

- 107. On the basis of the competition that would remain post-merger in all relevant markets, including refrigeration components, coupled with the ease and low cost at which installers could self-supply, we do not consider it likely that there would be a substantial lessening of competition in any of the relevant markets. As such, there is no need to consider potential competition and the conditions of entry. For the purposes of completeness, we nonetheless do so.
- 108. In terms of specific entry, the applicant submits that Actrol in Australia would be able to enter New Zealand, potentially through an online presence.
[]⁹¹ Furthermore, evidence from the
[]⁹²
- 109. The entry of RefSpecs into the market and its growth over five years, indicates that installers are willing to source products from a new entrant.
- 110. In the remainder of this section, we consider any specific barriers to entry and expansion in regard to any of the relevant markets.

Barriers to entry and expansion

Branch network

- 111. Discussions with competitors highlighted the importance of a branch network to compete with Patton and Realcold, including
[] [] also emphasised the

⁸⁸ Interview with [] 2 September 2015
⁸⁹ Application at []
⁹⁰ Interview with [] 2 September 2015.
⁹¹ Interview with [] 2 September 2015.
⁹² [] 15 September 2015.

importance of the branch network not only to service time, which is critical to the purchase of refrigeration components, but to the creation of a brand and to carve out a reputation.⁹³

112. However, RefSpecs successfully entered the refrigeration equipment, refrigeration components and refrigerants markets five years ago with one branch in Auckland. Since then it has expanded its offering to cover air conditioning components.
[
] It is important to note though that RefSpecs was started by a former employee of Realcold who had existing relationships and networks.
[
].⁹⁴
113. The use of sales representatives or territory managers is one way of overcoming the costs associated with establishing a branch. However, sales representatives from competitors may be less effective where branches already exist. For example, [] has sales representatives covering the South Island from its branches in [] []. Its sales representatives also cover [] branch but [] []. While [] outlined that they have had to invest in inventory since the closure of the Whangarei Realcold branch,⁹⁵ the support [] has mitigated some of the costs associated with the loss of a branch for [].⁹⁶
114. Another way expansion could occur could be through sponsoring entry in certain areas of the country as is the case with []. In that case, [] found that its warehouse in [] was tying up cash flow, so it arrived at a supply agreement with [], whereby [] own the warehouse and [] owns the stock with [] buying stock as and when needed.⁹⁷
115. In summary, while a local branch may provide a competitive advantage, entry does not require a whole network. Moreover, there are examples of successful entry and expansion with the use of sales representatives.

Specialist staff

116. Two competitors have indicated that a barrier to entry and expansion is access to specialised staff, particularly refrigeration technicians in the supply of refrigeration equipment due to the need to provide technical advice.^{98 99} Furthermore,

⁹³ Interview with [] 2 September 2015.

⁹⁴ Interview [] 1 September 2015.

⁹⁵ Interview with [] 24 September 2015.

⁹⁶ Interview with [] 24 September 2015.

⁹⁷ Interview with [] 14 September 2015.

⁹⁸ Interview [] 1 September 2015.

[] due to a lack of such staff.¹⁰⁰ Information provided by Immigration New Zealand indicates that there is a shortage of such staff in New Zealand.¹⁰¹ This shortage could be exacerbated by restraint of trade clauses in contracts.

117. We understand that

[¹⁰²]
¹⁰³]

118. [

].

119. [

].

120. [

].

Access to brands

121. [

¹⁰⁴]

Countervailing power

122. Self-supply through the importation of refrigeration equipment and associated componentry was raised in discussions with installers. However, [] stated [that the extent to which it is subject to competition from overseas or online is "...mainly limited to larger contractors who have the ability to import refrigeration

⁹⁹ Information [] on 11 September 2015.

¹⁰⁰ Interview with [] 2 September 2015.

¹⁰¹ <http://skillshortages.immigration.govt.nz/assets/uploads/canterbury-shortage-list-2015-06-29-.pdf>

¹⁰² []

¹⁰³ []

¹⁰⁴ Interview [] 1 September 2015.

equipment and less of an issue with components".¹⁰⁵ This is reflected in the discussions with national installers.

123. For example,

[
]¹⁰⁶

124. When asked about self-supply, [] indicated that it could supply from overseas, [] but would prefer not to and instead prefers to switch between Patton, Realcold, Heatcraft and more recently RefSpecs.¹⁰⁷

125. [] would consider self-supply but understands that there are likely to be costs such as re-training staff and cash flow tied up in components.¹⁰⁸

126. []
]¹⁰⁹

127. In summary, self-supply is more likely an option in the refrigeration equipment area than in the refrigeration components or refrigerants area and for national installers who already may have some experience of importing refrigeration equipment.

Conclusion on horizontal effects

128. In the event of the merger, we consider that there is sufficient scope for rival suppliers to provide constraint to the parties. In terms of refrigerants, air conditioning units and air conditioning components there are at least two other competitors who can supply installers if the proposed merged entity were to raise prices or reduce supply.

129. With respect to refrigeration equipment the existence of Heatcraft and installers' ability to import units provides sufficient competitive constraint on the proposed merged entity to increase prices in this market.

130. On refrigeration components, Heatcraft's branch network, installers' ability to hold additional inventory and the regular updating of refrigeration equipment provides sufficient constraint on the proposed merged entity to increase prices and provides the incentive on the proposed merged entity to continue to stock existing brands .

131. When all of these factors are taken into account, we do not consider that the proposed merger is likely to result in a substantial lessening of competition in the markets outlined in paragraph 45.

¹⁰⁵ Information submitted by [] on 8 September 2015 at 7.

¹⁰⁶ Interview with [] 9 September 2015.

¹⁰⁷ Interview with [] 8 September 2015.

¹⁰⁸ Interview with [] 9 September 2015.

¹⁰⁹ Interview with [] 14 September 2015.

Coordinated effects

- 132. We understand that refrigeration equipment and bulk amounts of refrigerant are likely to be competitively tendered.¹¹⁰ Information submitted by Realcold suggested that there could be information flows from customers to suppliers seeking better deals and looking to leverage rebates.^{111 112}
- 133. However, we do not consider that these information flows would facilitate coordination given the constraint provided by installer’s ability to self-supply and that some competitors also supply to the proposed merged entity.

¹¹⁰ Information submitted by [] on 8 September 2015 at 6
[].

¹¹¹ Information submitted by [] on 8 September 2015 at 6
[].

¹¹² Information submitted by [] on 8 September 2015 at 7
[].

Determination on notice of clearance

134. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
135. Under s 66(3)(a) of the Commerce Act 1986 the Commission determines to give clearance to the proposed acquisition.

Dated this 6th day of October 2015

Dr Mark Berry
Chairman