

Statement of Preliminary Issues

Rheem New Zealand Limited/Peter Cocks (2010) Limited

28 October 2015

Introduction

1. Rheem New Zealand Limited (Rheem, or the Applicant) is proposing to acquire the business and assets of Peter Cocks (2010) Limited (Peter Cocks). On 15 October 2015, the Commerce Commission registered an application from Rheem seeking clearance for the proposed acquisition.
2. The public version of the application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/874>
3. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication and may change as our assessment of the application for clearance progresses.
4. We invite interested parties to make comment on the likely competitive effects of the proposed acquisition and request that parties who wish to make a submission do so by **11 November 2015**.

The transaction and the parties

5. Rheem, which forms part of the Japanese-based Paloma group of companies, manufactures and supplies a full range of water heaters for distribution throughout New Zealand for both domestic and commercial use. This includes:
 - 5.1 electric water heaters (low and mains pressure);
 - 5.2 gas water heaters (continuous flow and storage);
 - 5.3 dairy water heaters; and
 - 5.4 solar water heaters.
6. Rheem has a factory in Auckland, where most of its products are made with the remainder imported. It also produces tubular electric water heater elements through its Hermetic New Zealand division. It distributes its products nationwide through dedicated plumbing merchants and large building merchants.

7. Peter Cocks is a privately-owned family business which manufactures and supplies the following for domestic and commercial uses:
 - 7.1 electric water heaters (low and mains pressure);
 - 7.2 solar capable hot water cylinders; and
 - 7.3 dairy water heaters.
8. Peter Cocks has a factory in Christchurch where it manufactures low pressure cylinders and finishes main pressure cylinders that are imported from the UK. It distributes most of its products in the South Island through dedicated plumbing merchants and a small share through large building merchants and solar specialists.

Our framework

9. As required by the Commerce Act 1986, we assess whether an acquisition of shares is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.¹
10. We ask 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).²
11. A tool used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.³ A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of “fact and commercial common sense”.⁴
12. 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 define the boundaries of a market.
13. We analyse the extent of competition in each relevant market both with and without the acquisition to determine whether the acquisition would be likely to substantially lessen competition.
14. When making that assessment, we consider, among other matters:

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 *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

⁴ Similarly, the courts have said that “[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices”. See *Commerce Commission v New Zealand Bus Limited* (HC), above n 3 at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

- 14.1 Existing competition – the degree to which existing competitors compete.
- 14.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.
- 14.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser’s ability to exert substantial influence on negotiations.

Preliminary issues

- 15. We will assess whether the proposed acquisition is likely to substantially lessen competition in the relevant markets by focusing on the unilateral and coordinated effects that might result from this acquisition. In particular, we will consider:
 - 15.1 whether separate product markets exist for the manufacture and supply of electric water cylinders (low and mains pressure), solar hot water cylinders (including solar-capable) and dairy water cylinders;
 - 15.2 the closeness of competition between the merging parties and other suppliers;
 - 15.3 the ability for new suppliers to enter or for existing suppliers to expand, by extending the range and geographic coverage of their operations;
 - 15.4 the ability of customers to exert substantial influence on the price the merged entity charges and on other terms; and
 - 15.5 whether the merger is likely to increase the ability of the merged entity and all or some of its remaining competitors to coordinate their behaviour on price or any other dimension of competition.

Market definition

- 16. Rheem submitted that the appropriate market definition for analysis of the proposed merger is the nationwide supply of hot water heaters to wholesalers.
- 17. We will consider whether separate markets exist for:
 - 17.1 electric water heaters (low and mains pressure);
 - 17.2 solar capable hot water cylinders; and
 - 17.3 dairy water heaters.
- 18. We will also consider whether separate markets exist for different wholesale customers (e.g. dedicated plumbing merchants vs large building merchants) and assess how plumbers through their purchases at wholesalers influence the market.

19. With respect to geographical market definition, we will consider whether separate markets exist for hot water heaters in South Island and North Island given:
- 19.1 the lack of brand awareness of Peter Cocks outside the South Island;⁵
 - 19.2 the transport costs associated with supplying a national market;⁶
 - 19.3 current sales distribution of Peter Cocks's products; and
 - 19.4 the relatively low take up of gas water heaters in the South Island given there is no South Island wide reticulated gas.

Existing competition

20. Rheem submitted that post-acquisition it will continue to face strong competition from firms who operate in the same market. Competitors it has identified include:
- 20.1 Rinnai New Zealand, a subsidiary of Japanese based Rinnai Corporation, and HJ Cooper Limited which Rinnai acquired in 2012;
 - 20.2 Robert Bosch (Australia) Pty Limited (Bosch) part of the German based Bosch Group;
 - 20.3 Dux Manufacturing Limited, an Australian manufacturer supplying to New Zealand through Caroma Industries (NZ) Limited, a New Zealand subsidiary of GWA Group Holdings Limited;
 - 20.4 Sigma Sheetmetal Products Limited based in North Island;
 - 20.5 Superheat Limited based in South Island; and
 - 20.6 Valley Industries based in South Island.
21. Our investigation will focus on the closeness of competition between the merging parties, and between the merging parties and other competitors. In doing so, we will consider whether the merged entity would be effectively constrained from raising its prices above the competitive level, or reducing the quality of its services by the existing competition.
22. We will also assess whether there are any major costs or other impediments (such as rebates) involved in customers switching between water heater suppliers and the likely impact of the acquisition on their ability to switch.

⁵ Application at 10.

⁶ Application at 10 states that: *"the degree of restraint imposed on Rheem by Peter Cocks in the (national) hot water heater market is limited to an extent by the freight disadvantage Peter Cocks suffers supplying units outside the South Island."*

Potential competition

23. Rheem submitted that, barriers to entry for new market participants and barriers to expansion for existing competitors are low and as such entry or expansion is likely, to be sufficient in extent, and to occur in a timely manner.
24. We will assess whether entry by new competitors or expansion by existing competitors is likely, of sufficient extent and would occur in a timely fashion to prevent a substantial lessening of competition.

Countervailing power

25. We will consider whether the countervailing power of wholesale customers (large plumbing suppliers and merchants) will be able to sufficiently constrain the merged entity from profitably increasing prices or reducing the quality of its services, including for instance by switching hot water heater suppliers or by self-supplying through direct importation and/or developing an alternative 'house brand' to compete with Rheem.

Coordinated effects

26. Rheem submitted that the conditions necessary for effective and sustainable coordinated behaviour are not present in the market for manufacture and supply of hot water heaters in New Zealand.
27. We will consider whether the merger increases the potential for the merged entity and all or some of its competitors to coordinate their behaviour and collectively exercise market power such that output or quality reduces, and/or prices increase, across the markets.
28. We will also assess:
 - 28.1 whether the market is vulnerable to coordination; and
 - 28.2 whether the merger is likely to change the conditions in the market so that coordination is more likely, more complete or more sustainable.

Next steps

29. We are currently aiming to make our decision by **11 December 2015**. However, this date may change as the investigation progresses.
30. To keep up to date with any changes to our deadline and to find relevant documents, visit our clearance register on our website at <http://www.comcom.govt.nz/clearances-register/>
31. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above. We will be contacting those parties over the next few weeks.

32. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please email it to us at registrar@comcom.govt.nz with the reference Rheem/PeterCocks in the subject line of your email, or post it to us at The Registrar, PO Box 2351, Wellington 6140 by close of business **11 November**. Please clearly identify any confidential information contained in the submission and provide contact details.
33. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. For example, if disclosure would unreasonably prejudice the supplier or subject of the information.