Statement of Preliminary Issues

Atlas Copco / Ash Air businesses

15 April 2014

Introduction

1. On 1 April 2014, the Commerce Commission received an application from Atlas Copco South Pacific Holdings Pty Limited (Atlas Copco) seeking clearance to acquire some of the following Lancaster Group Limited businesses: Ash Air (N.Z) Limited, Ash Air Oil & Gas Limited, mbar 2011 Limited, and Fox Air NZ Limited (together, the Ash Air businesses).

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/814

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. Therefore, the issues highlighted in this statement are not binding on us.

4. We invite interested parties to make comment on the likely competitive effects of the proposed joint venture and request that parties who wish to make a submission do so by **Wednesday 30 April 2014**.

The transaction

5. Atlas Copco intends to acquire the Ash Air businesses from Lancaster Group Limited. The Ash Air businesses primarily import, distribute and service a range of air compressors, blowers, vacuum pumps and air treatment products.

Relevant parties

The acquirer – Atlas Copco South Pacific Holdings Pty Limited

6. Atlas Copco is a subsidiary of Atlas Copco Group, which is based in Sweden. The Atlas Copco Group manufactures and distributes a range of equipment including air compressors, blowers, vacuum pumps and air treatment products. Atlas Copco imports and distributes this equipment in New Zealand, as well as providing the necessary maintenance services for this equipment.

7. In New Zealand, the Atlas Copco Group owns the following brands of air compressors, vacuum pumps and blowers:

    7.1 Atlas Copco;

    7.2 Chicago Pneumatic;

    7.3 Ceccato;

7.4 ABAC; and

7.5 Edwards.

The target – Ash Air

8. The Ash Air businesses are wholly owned subsidiaries of Lancaster Group Limited. Like Atlas Copco in New Zealand, Ash Air imports, distributes and services a range of equipment including air compressors, blowers, vacuum pumps and air treatment products.

9. Unlike Atlas Copco Group, Ash Air does not manufacture any of these products itself. Rather, it holds the rights to distribute certain manufacturer's equipment in New Zealand. At present, Ash Air distributes the following brands:

9.1 ABAC for Atlas Copco;

9.2 CompAir and Hydrovane for Gardner Denver;

9.3 Ingersoll Rand;

9.4 Mitsui Seiki; and

9.5 Pompetravaini.

Our framework

10. As required by the Commerce Act 1986, we assess whether a merger is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.[1]

11. We ask 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]

12. 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]

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013.

[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

13. We define markets in the way that we consider best isolates the key competitive constraints on the merging parties. In many cases this may not require us to precisely define the boundaries of a market.

14. We analyse the extent of competition in each relevant market both with and without the merger to determine whether the merger would be likely to substantially lessen competition.

15. We assess the following three factors when considering whether this is likely to be the case.

    15.1 Existing competition – the degree to which existing competitors compete.

    15.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.

    15.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by a purchaser's ability to exert substantial influence on negotiations.

16. A comparison of the extent of competition both with and without the merger enables us to assess the degree by which the proposed merger might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed merger.

Preliminary issues

17. The Commission will assess the horizontal and vertical effects that might arise as a result of this merger.

Areas of overlap

18. We understand that both Atlas Copco and Ash Air import and distribute:

    18.1 a full range of air compressors;

    18.2 associated equipment and parts (including hoses, piping and fittings for compressed air and air tools);

    18.3 blowers and vacuum pumps; and

    18.4 plant and products for the treatment of compressed air.

19. Within each product group, we will consider which subset of products or brands customers consider to be close substitutes and which parties currently supply such products in New Zealand. This supply could be either directly via an overseas-based manufacturer or distributor (like Atlas Copco), or through an independent New

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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.

Zealand-based distributor who has a supply arrangement in place with a manufacturer (like Ash Air).

20. The various types of products, such as air compressors, blowers, and vacuum pumps, each appear to be differentiated by type (such as a piston or rotary screw air compressor) and by capacity. We will therefore consider whether the degree of differentiation impacts on the ability of parties to import and to distribute this type of equipment in New Zealand.

21. In addition, we understand that both Atlas Copco and Ash Air maintain and service the range of products they import and distribute, and provide replacement parts for such equipment. We will consider if there is a separate market for the maintenance and servicing of the different types of air compressors, blowers, vacuum pumps, and related equipment.

22. Atlas Copco submitted that there is a national market for the importation and distribution of the different types of equipment listed above as a full range of products can be imported and distributed throughout New Zealand relatively easily. However, Atlas Copco submitted that there are regional after-sales service markets for the maintenance and servicing of this equipment because the servicing work is often urgent, requiring localised service staff.

23. We will also consider the relevant geographic markets.

Existing competition

24. Atlas Copco and Ash Air advised that the merged entity would continue to face strong competition from an array of distributors that distribute products from a number of large, international manufacturers.

25. For both distribution and servicing of the different types of compressor equipment, we will consider the closeness of competition between Atlas Copco and Ash Air. We will then consider the degree of competitive constraint that would be provided by existing importers and distributors including whether New Zealand-based distributors would be able to obtain and secure licensing arrangements with overseas manufacturers for the supply of different types of compressor equipment.

26. Atlas Copco notes that, in respect to maintenance services, there would be more aggregation between Ash Air and itself in Tauranga, Palmerston North and Dunedin than in other areas of the country. We will consider the extent to which Atlas Copco and Ash Air compete in the regions where they both have a presence.

Potential competition

27. Entry conditions in the distribution market, and separately any regional service markets, will be important considerations for our assessment.

28. Atlas Copco advised that for greenfields entry, a distributor would require:

28.1 a distribution agreement with an international manufacturer of the relevant products;

28.2 warehousing space and logistical support;

28.3 a sales network; and

28.4 trained mechanics and technicians to provide maintenance and other servicing.

29. Some of the additional market characteristics we will consider when assessing the ability and incentives of firms to enter and/or expand in the relevant distribution and servicing markets include:

29.1 warranties and maintenance contracts; and

29.2 the length and terms of distribution agreements.

30. We will consider whether entry or expansion would be likely, timely and sufficient in extent to constrain the merged entity.

Countervailing power

31. Atlas Copco considers that large customers have a substantial degree of countervailing power. A customer may have countervailing power to constrain the exercise of any market power by the merged entity if it can, among other things:

31.1 punish a price increase by switching purchases in other markets;

31.2 self-supply either by importing product directly or self-servicing; or

31.3 sponsor entry.

32. We will also consider whether any potential countervailing power would be limited to individual firms or if it could be extended to protect the market from anti-competitive price increases.

Vertical integration of product manufacturing with distribution and servicing

33. Atlas Copco and Ash Air are both distributors, and Atlas Copco is vertically integrated into manufacturing. Therefore, we will consider whether any vertical effects result from this merger.

34. Foreclosure of rival distributors can occur if Atlas Copco has the ability and incentive to either deny their product to competing distributors, or is able to limit access of its rivals to customers.

35. In order to do so Atlas Copco would have to have market power at the manufacturing level as well as sufficient capacity at the distribution and servicing level to absorb all the demand for the Atlas Copco products.

Next steps

36. We are currently aiming to make our decision by **Monday 16 June 2014**. However, this date may change as the investigation progresses.

37. 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/

38. 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.

39. 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 send it to us at registrar@comcom.govt.nz with the reference Atlas Copco/Ash Air in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business **Wednesday 30 April 2014**. Please clearly identify any confidential information contained in the submission and provide contact details.