COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

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Statement of Preliminary Issues

Vero Insurance New Zealand Limited and Tower Limited

16 March 2017

Introduction

1. On 2 March 2017 the Commerce Commission received an application from Vero Insurance New Zealand Limited (Vero) seeking clearance to acquire up to 100% of the shares in Tower Limited (Tower).

2. The Commission will give clearance if it is satisfied that the proposed merger will not have or would not be likely to have the effect of substantially lessening competition in a market in New Zealand.

3. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[1]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed merger. We request that parties wishing to make a submission do so by **Thursday 6 April 2017**.

The parties

5. Vero is a New Zealand subsidiary of Suncorp Group Limited (Suncorp), an Australian-based finance, insurance, superannuation and banking business. Suncorp, through Vero, Asteron Life and AA Insurance provides personal and commercial insurance products direct to customers and through insurance brokers and banks. While Vero is the party that has applied for clearance, we will take into account all of Suncorp's insurance activities in New Zealand in assessing the proposed acquisition.

6. Tower is a New Zealand-based insurance company that provides personal and commercial insurance products direct to customers and through banks.

7. Vero currently holds 19.99% of the shares in Tower. The proposed acquisition would result in Vero owning up to 100% of the shares in Tower.

Our framework

8. Our approach to analysing the competition effects of the proposed merger is based on the principles set out in our Mergers and Acquisitions Guidelines.[2] As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

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[1] The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

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

9. 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).[3]

10. 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. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[4]

11. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the proposed merger might lessen competition. If the lessening is likely to be substantial, we will not give clearance to the proposed merger. When making that assessment, we consider, among other matters:

    11.1 constraint from existing competitors – the degree to which existing competitors currently compete and the extent to which they would expand their sales if prices were increased;

    11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete effectively if prices were increased; and

    11.3 the countervailing market power of buyers – the potential for a business to be sufficiently constrained by a buyer's ability to exert substantial influence on negotiations.[5]

Market definition

12. Suncorp and Tower both supply personal and commercial insurance. Vero submitted that the relevant markets for assessing the proposed acquisition are:[6]

    12.1 national markets for the insurance of:

        12.1.1 domestic house and contents;

        12.1.2 private motor vehicle;

        12.1.3 private pleasure craft;

        12.1.4 commercial motor vehicle;

        12.1.5 commercial property insurance (including business interruption); and

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

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

5 Countervailing power is more than a customer's ability to switch from buying products from the merged entity to buying products from a competitor. Similarly, a customer's size and commercial importance is not sufficient in itself to amount to countervailing power.

6 Application at [7.7-7.8].

12.1.6 various forms of liability (including commercial liability;

12.2 national buying markets for:

12.2.1 auto-glass and windscreen repair/replacement services; and

12.2.2 collision repair services.

13. The Commission previously considered the above markets in *IAG/Lumley* and *IAG/AMI*.[7]

14. The proposed acquisition would result in an aggregation at the underwriting and distribution levels of the market. However, the main focus of our investigation is likely to be on the underwriting level. We will also consider the impact of the proposal on the distribution of insurance to consumers through intermediaries such as brokers and banks.

15. We will also consider whether the proposed acquisition involves other affected markets (eg, a buying market for roadside assistance services, or other markets for insurance such as further product markets or customer markets).

16. In terms of the geographic dimension of the markets, we will assess whether it is appropriate to define the relevant insurance products and buying markets as national in scope, as we have done previously, or to modify that approach. For instance, we will investigate whether recent earthquakes and other market developments have affected the choices available to consumers in different parts of New Zealand, such that it may be appropriate to define narrower geographic markets.

Without the acquisition

17. Vero submitted that, absent it acquiring Tower, Tower would remain a separate entity, implying a without-the-acquisition scenario not materially different to the status quo.[8]

18. Canadian company Fairfax Financial Holdings Limited has also made an offer to purchase Tower. In forming our view of the likely without-the-acquisition scenario, we will consider whether a different state of competition (than the status quo) would be likely if Fairfax Financial Holdings Limited was the owner of Tower.

Preliminary issues

19. We will investigate whether the proposed acquisition is likely to substantially lessen competition in personal and commercial insurance markets by looking at the unilateral and coordinated effects that might result from a merger of Vero and Tower.

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7 IAG (NZ) Holdings Limited and Lumley General Insurance (N.Z.) Limited [2014] NZCC 12 and IAG (NZ) Holdings Limited and AMI Insurance (Operations) Limited [2012] NZCC 6.

8 Application at [5.7].

20. We will also assess whether the proposed acquisition may lessen competition by increasing Suncorp's ability, unilaterally or in coordination with other firms, to exercise market power when buying products (for example, when buying collision repair services).

Unilateral effects: would the merged entity be able to raise prices by itself?

21. Where two suppliers compete in the same market, a merger could remove a competitor that would otherwise provide a competitive constraint, allowing the merged entity to raise prices. A merger could also reduce competition if the target was a potential or emerging competitor. In such a case, a merger could result in higher prices compared to the scenario without the merger.[9]

Existing competition

22. Vero submitted that the proposed acquisition would not enable the merged entity to raise prices (or decrease quality) as a result of unilateral effects because:[10]

    22.1 the degree of market share aggregation that would result from the proposed acquisition is low;

    22.2 the merged entity would face strong competition from substantial and well-established existing competitors, as well as smaller competitors;

    22.3 Vero and Tower are not each other's closest competitors in personal insurance markets. Instead Vero's closest competitors in these markets are IAG and Youi; and

    22.4 Tower has only a small presence in commercial insurance markets, such that Vero's acquisition of Tower would not materially change existing competition in these markets.

23. We will consider:

    23.1 the closeness of competition between Suncorp and Tower in all relevant markets;

    23.2 the closeness of competition between the merged entity and alternative insurance providers, including overseas providers (including whether Tower is a particularly dynamic third competitor in any market and therefore whether the merger would remove such competition);

    23.3 the extent to which intermediaries such as banks are likely to act as a competitive constraint on the merged entity;

    23.4 the scope for existing insurance providers to expand so as to more closely compete with the merged entity; and

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9 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at [3.62-63].

10 Application at [8.1-8.24].

23.5 the scope for purchasers of insurance products to switch to alternative providers in the event the merged entity raises its prices (or decreases the quality of its products).

Potential competition

24. Vero submitted that the barriers to entry in both the commercial and personal insurance markets are not significant, as evidenced by recent entry and expansion in these markets in the past two years. It submitted that there is a high likelihood of entry and expansion in both the commercial and personal insurance markets that would constrain the merged entity.[11]

25. We will consider entry and expansion conditions and whether entry or expansion would be likely, timely, and sufficient in extent to prevent a substantial lessening of competition.

Countervailing power

26. Vero submitted that the countervailing power of individual consumers, banks and brokers would continue to provide a significant constraint on the merged entity in personal insurance markets.[12] In commercial insurance markets, Vero submitted that the exercise of countervailing power by brokers and customers with the potential to self-supply would constrain the merged entity.[13]

27. We will consider the extent of countervailing power held by intermediaries such as brokers and banks, including the scope for them to discipline the merged entity in other markets, or sponsoring new entry (including self-supply).

Coordinated effects: would the merged entity be able to coordinate with rivals to raise prices?

28. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[14]

29. Vero submitted that the relevant markets do not have any of the structural features that potentially facilitate coordinated conduct.[15]

30. We will assess whether any of relevant markets are vulnerable to coordination, and whether the merger would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable. Some of the factors we will consider are:

[11] Application at [8.25] and [8.36].
[12] Ibid at [8.41-8.49].
[13] Ibid at [8.50].
[14] Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [3.84].
[15] Application at [8.51].

30.1 whether the characteristics of the product or service makes coordination likely. This may be the case when:

30.1.1 the products are homogenous;

30.1.2 there is little innovation and stable demand;

30.1.3 firms can easily observe each other's prices; and

30.1.4 there is repeated interaction;

30.2 whether the merger will leave any markets with only a few rivals or eliminate a vigorous competitor;

30.3 whether the firms in the market are similar (for example, in size and cost structure) such that they will have similar incentives to coordinate;

30.4 whether interactions between suppliers enhance the potential for coordination; and

30.5 whether the threat of entry or the countervailing power of customers or suppliers would disrupt any attempts to coordinate.

Buying markets: would the merged entity be able to exercise market power to depress prices?

31. Buyer market power is the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time such that the amount of input sold is reduced. That is, the price of the product is depressed so low that (some) suppliers no longer cover their supply costs and so withdraw supply (or related services) from the market.[16]

32. Suncorp and Tower currently compete to buy services to fulfil their claims obligations, including windscreen repair/replacement and collision repair services.

33. Vero submitted that the removal of Tower from buying markets would be unlikely to strengthen the merged entity's buyer power to such an extent that a substantial lessening of competition would be likely, because Tower has a small market share.[17]

34. We will consider:

34.1 whether the increase in Suncorp's market share as a result of the merger would create or strengthen its market power; and

34.2 whether the merged entity would have an incentive to depress prices paid to suppliers to a level below the competitive price.

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16 Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [4.2].

17 Application at [8.24].

Next steps in our investigation

35. The Commission is currently scheduled to make a decision on Vero's application by **5 May 2017**. This date may change as our investigation progresses.[18] In particular, if we need to test and consider the issues identified further, the decision date is likely to extend.

36. As part of our investigation, we will be identifying and contacting parties we consider will be able to help us assess the preliminary issues identified above.

Making a submission

37. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Vero/Tower in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **Thursday 6 April 2017**.

38. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

39. 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. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.

[18] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.