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Determination

Z Energy Limited and Chevron New Zealand [2016] NZCC 10

The Commission:	Dr Mark Berry Sue Begg Anna Rawlings Dr Jill Walker (dissenting)
Summary of application:	An application from Z Energy Limited seeking clearance to acquire 100% of the shares in Chevron New Zealand.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission gives clearance for Z Energy Limited to acquire 100% of the shares in Chevron New Zealand subject to the divestment undertaking dated 28 April 2016 provided by Z Energy Limited under section 69A of the Commerce Act 1986.
Date of determination:	29 April 2016

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

Contents

Acronyms and abbreviations

Air New Zealand	Air New Zealand Limited
Allied	Allied Petroleum Limited
Aratuna	Aratuna Freighters Limited
BP	BP Oil New Zealand Limited
Chevron	Chevron New Zealand
COLL	Coastal Oil Logistics Limited
Commission	Commerce Commission
Company sites	Retail sites that are directly operated by the major fuel firms or Gull
cpl	Cents per litre
CSAT	Crude Supply and Trading
Dealer sites	Retail sites that carry the brand of the major fuel firms or Gull but are owned and operated by individual owners
Downer	Downer New Zealand Limited
Farmlands	Farmlands Co-operative Society Limited
Foodstuffs	Collective term for Foodstuffs (New Zealand) Limited, Foodstuffs Own Brands Limited, Foodstuffs North Island Limited and Foodstuffs South Island Limited
GAS	Gasoline Alley Services Limited
GRM	Gross refining margin
Gull	Gull New Zealand Limited
Independent sites	Retail sites that are owned and operated independently from the major fuel firms and Gull
JIFS	Joint into-plane refuelling services
JRSOA	Joint ramp service operations agreement
JUHI	Joint user hydrant installation
LET test	Test as to whether entry is likely in commercial terms, sufficient in extent to cause market participants to react in a significant manner; and timely, that is, feasible within two years from the point at which market power is first exercised
McFall	McFall Fuel Limited
McKeown	McKeown Group Limited

Major fuel firms	Collective term for Z, Chevron, BP and Mobil
Majority	The members of the Division of the Commission that made this Determination (being Dr Mark Berry, Sue Begg and Anna Rawlings)
[	]
Mobil	Mobil Oil New Zealand Limited
MOPS	Mean of Platts Singapore
MPP	Main port price
NPD	Nelson Petroleum Distributors Limited
NZRC	The New Zealand Refining Company Limited
RAP	Refinery-to-Auckland pipeline
Refinery	Refinery operated by NZRC
Remaining major fuel firms	Collective term for Z, BP and Mobil
RD	RD Petroleum Limited
Rural Fuel	Rural Fuel Limited
RWP	Regional wholesale price
s	Section
Sites	Service stations, unmanned sites or truck stops
Southfuels	Southfuels Limited
Toll	Toll (New Zealand) Limited
Undertaking	Divestment undertaking provided by Z, attached as Attachment A
uscg	US cents per gallon
Waitomo	Waitomo Petroleum Limited
WAP	Wiri-to-Auckland Airport pipeline
We	The members of the Division of the Commission that made this Determination (being Dr Mark Berry, Sue Begg and Anna Rawlings)
Wealleans	Wealleans Allied Petroleum Limited
WOSL	Wiri Oil Services Limited
Z	Z Energy Limited

Executive summary

The proposed merger

X1. The applicant, Z Energy Limited (Z), seeks clearance to acquire 100% of the shares in Chevron New Zealand (Chevron) (the Application). The proposed merger would combine the Z and Caltex brands under Z's ownership.

X2. Z provided the Commission with an undertaking to divest 19 service stations and one truck stop to remedy any substantial lessening of competition arising from the proposed merger.

The decision

X3. We give clearance to the proposed merger, subject to the divestment undertaking provided by Z, as we are 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. This includes markets for the supply of:

X3.1. terminal storage facilities;

X3.2. fuel to retail customers through services stations, subject to 19 divestments;

X3.3. bitumen;

X3.4. aviation fuel;

X3.5. petroleum products to commercial customers;

X3.6. diesel to commercial customers at truck stops, subject to one divestment; and

X3.7. marine fuel.

X4. For the reasons explained in her dissenting opinion, Dr Walker is not satisfied that the proposed merger would not increase the ability of the remaining fuel firms to coordinate on retail pricing. For this reason, Dr Walker dissented from the decision to give clearance.

Industry to which the proposed merger relates

X5. The proposed merger relates to the refining, distribution, storage and supply of petroleum products to commercial and retail customers.

X6. The types of refined fuel products supplied in New Zealand include petrol, diesel, aviation fuel, marine fuel and bitumen, which we discuss further below. Table X1 summarises the approximate volumes of these products consumed in New Zealand per annum and the major consumers of those products.

Table X1: Refined products

Refined product	Approx market size	Customers
Petrol	3,034 million litres	Retail consumers
Diesel	2,963 million litres	Transport, manufacturing, construction companies and retail consumers
Aviation fuel	1,272 million litres	Airlines
Marine fuel	0.466 million litres	Freight, fishing, ferry, cruise lines
Bitumen	160-180 kilo tonnes	Roading companies

Source: Z Investment Statement and Prospectus (25 July 2013) and Z "Bitumen strategy" (14 July 2014)

X7. All of these petroleum products come from refining crude oil. Some petroleum products supplied in New Zealand are domestically refined and some are imported. New Zealand's four major fuel firms (Z, Chevron, BP Oil New Zealand Limited (BP) and Mobil Oil New Zealand Limited (Mobil)) import crude and refine it domestically into petroleum products at a refinery that is owned and operated by The New Zealand Refining Company Limited. The major fuel firms also import refined petroleum products. We consider that the proposed merger would have no material impact on the supply of refinery services.

X8. The major fuel firms own the majority of the infrastructure used to distribute, store and supply petroleum products to commercial and retail customers. This includes storage terminals, coastal shipping vessels used to deliver products from the refinery to storage terminals, and pipelines. We do not have concerns over the impact of the proposed merger on infrastructure that is jointly owned by the major fuel firms. We discuss below our views on specific terminal storage facilities. Where relevant, we consider the extent to which access to such infrastructure impacts on the ability of fuel firms to compete in the various downstream markets supplied using this infrastructure.

X9. After the major fuel firms, Gull New Zealand Limited (Gull) is the next largest supplier of petroleum products. Gull does not have the ability to refine crude domestically and instead tenders for its supply of refined fuel internationally.

X10. Other major market participants in the supply of petroleum products are resellers and independent retail networks. Resellers purchase fuel from the major fuel firms on a wholesale basis and on-sell that fuel in bulk to commercial customers. Many resellers also sell fuel through their own network of truck stops and service stations.

The supply of terminal storage facilities

X11. Refined fuel products are delivered to, and stored in, terminals until dispensed for use in downstream markets. In general, terminals are located at coastal ports, although a notable exception is Mobil's inland terminal at Woolston in Christchurch. The major fuel firms have access to each other's terminals under a borrow and loan system, which enables the firms to charge each other throughput fees to draw down fuel from a terminal they do not own.

X12. Post-merger, Z would own and control a greater proportion of terminal storage facilities at ports around New Zealand. In particular, Z would own all the terminals at

Timaru and almost all the terminals at Nelson. However, Z would continue to require access to terminals BP and Mobil own elsewhere, ensuring they would have countervailing power to constrain Z from substantially increasing the price for access to its terminals or reducing its quality of service. Therefore, we do not consider that Z's increased ownership of terminal storage facilities would impact on BP and Mobil's ability to compete in the downstream markets in these areas.

The supply of fuel to retail customers through service stations

X13. Z and Chevron operate differently at the retail level. Almost all the Z-branded service stations in New Zealand are owned and operated by Z, with Z setting the retail prices for fuel sold at these stations. In contrast, Chevron does not generally own service stations and instead supplies fuel to owner-operated Caltex-branded service stations (and other parties) on a wholesale basis. Chevron also supplies fuel on a wholesale basis to Farmlands Co-operative Society Limited, which in turn supplies fuel to independently-owned Challenge-branded service stations. Chevron owns the Challenge brand.

X14. Despite these differences, we consider that Z and Chevron impose a constraint on one another in the supply of fuel to retail customers through service stations. The terms of Chevron's typical wholesale agreement enable Chevron to influence its retailers' offer. As a result of the proposed merger, the constraint between Z and Chevron would be lost.

X15. In considering the impact of the proposed merger at the retail level, we considered whether it would be likely to substantially lessen competition in any one or more local retail markets either because removing Chevron would:

X15.1. allow Z to profitably increase the prices it charges to customers in areas where both Chevron and Z are present – referred to as unilateral effects; and/or

X15.2. allow the remaining major fuel firms (Z, BP and Mobil) to collectively exercise market power to raise or maintain prices above competitive levels (or to do so more effectively) – referred to as coordinated effects.

Unilateral effects

X16. We considered whether the proposed merger would allow Z to increase prices at service stations in local areas by removing Chevron as an independent competitive constraint.

X17. Following a detailed analysis of retail markets, we concluded that the proposed merger would have, or would be likely to have, the effect of substantially lessening competition due to an increase in unilateral market power in 22 local areas. Some of the 22 areas overlap. As such, Z was able to remedy those concerns through an undertaking to divest 19 service stations. The areas of concern are set out in Table X2, grouped according to the basis for our concerns.

Table X2: Local areas where we had concerns

Basis for concern	Local areas of concern
There would be a reduction of competitors from two to one in an isolated area	Darfield/Kirwee, Kaiapoi/Waimakariri, Kaikohe, Opotiki, Paihia and Te Aroha
There would be a reduction in the number of competitors from three to two, and the remaining constraints from competitors would be insufficient to prevent a substantial lessening of competition	Addington, Hutt Road, Kaitaia, Matamata, Milton, Motueka/Riwaka, Picton, Putaruru, Rangiora, Riccarton and Twizel
Z and Chevron are likely to be particularly close competitors due to traffic flows and the nature of customers	Epsom and Yaldhurst

X18. The divestment undertaking provided by Z remedied all of our concerns in the local areas set out in Table X2.

X19. In other local areas, we concluded that the merged entity would face sufficient competition from remaining BP, Mobil, Gull and/or independently-owned service stations operating under other banners.

Coordinated effects

X20. We assessed whether the proposed merger would have, or would be likely to have, the effect of substantially lessening competition due to coordinated effects between the remaining major fuel firms. We are satisfied it would not be likely to. Dr Walker has dissented on this point.

X21. Coordination involves firms in a market recognising that they can reach a more profitable outcome if they accommodate each other's price increases rather than competing. This shared knowledge (which we refer to as an "implicit agreement") may well fall short of a contract, arrangement or understanding which otherwise breaches Part 2 of the Commerce Act 1986.

X22. We started our assessment by looking at the characteristics that economic theory identifies as likely to make markets vulnerable to coordination, including an assessment of whether coordination is likely to be occurring in any local markets currently.

X23. To assess whether the proposed merger would create a substantial lessening of competition via coordinated effects requires us to compare competition in local markets with and without the merger. A conclusion that a substantial lessening of competition is likely in any local market will arise where there is a real chance that a merger would make a substantial difference, by making coordination more likely, complete or sustainable compared to the situation that would be likely to prevail without the merger.

X24. We are satisfied that the merger is not likely to substantially lessen competition in any local market due to coordinated effects. We reach this view for the following reasons.

X24.1. First, we do not consider that the merger would enhance the prospects for coordination in local markets where there is no aggregation.

X24.2. Second, in those markets where there would be aggregation, we do not think that local markets where Gull is present are likely to be vulnerable to coordination.

X24.3. Third, in the 22 most concentrated local markets where there is aggregation, the divestments that Z has offered remove the risk that the proposed merger would affect the prospects of coordination in those 22 local markets.

X24.4. Finally, for all other local markets, while it is possible that the markets are vulnerable to coordination (and it is possible that there is coordination already occurring), we consider that Chevron is not playing an important role in constraining any coordination such that the merger would not make a material difference to market outcomes. We, therefore, are satisfied that the merger would not remove an important obstacle to coordination occurring, and so would not be likely to substantially lessen competition in those local markets.

X25. Dr Walker's view differs from our own. She is not satisfied that the proposed merger will not have, or would not be likely to have, the effect of substantially lessening competition due to coordinated effects in local retail markets. Where we differ is that Dr Walker has concluded that the market place evidence suggests that retailers are already coordinating albeit that the coordination is more successful and complete in areas priced closer to main port price (primarily the Wellington region and the South Island). Dr Walker also concludes that she cannot exclude the real chance that removing Chevron would materially affect the prospects of coordination.

The supply of bitumen

X26. Bitumen is used in the construction and maintenance of roads and the production of asphalt. Both BP and Mobil ceased supplying bitumen in New Zealand a number of years ago, leaving Z and Chevron as the only two suppliers of domestically refined bitumen.

X27. In its application Z submitted that Chevron intended to exit the bitumen market, leaving Z as the sole domestic supplier regardless of whether the merger was approved. Chevron advised us that absent the proposed merger it would exit the market by December 2016. We accept this would be the likely outcome without the merger.

The supply of aviation fuel

X28. The supply of aviation fuel is, for most customers, a bidding market. These customers typically use competitive tender processes to obtain competitive prices.

X29. Our assessment of the aviation market focused on the potential for Z to raise the price that airlines pay for Jet A-1 fuel at Auckland Airport. Post-merger, Z would take

over Chevron's supply agreements, reducing the number of Jet A-1 providers from four to three. Air New Zealand Limited raised concerns that post-merger its supply of Jet A-1 would be concentrated in the merged entity and that its ability to switch volumes between the major fuel firms is limited.

X30. We do not consider that the proposed merger would have a substantial impact on competition for Jet A-1. We found no evidence to indicate that Chevron provided a stronger constraint than any other bidder, such that its removal from the market would mean that prices would rise post-merger. BP and Mobil have the ability to increase supply of Jet A-1 at Auckland Airport by increasing imports of Jet A-1 in Christchurch and Wellington, allowing them to divert refined product from these markets to Auckland Airport. We consider that this would constrain Z from substantially increasing its prices post-merger.

The supply of petroleum products to commercial customers

X31. The supply of petroleum products to commercial customers is also a bidding market.

X32. The major fuel firms compete directly or indirectly (through their resellers) to supply diesel to bulk commercial customers, such as freight companies, bus operators or smaller clients like farmers. Our assessment focussed on whether the merger would allow Z to raises prices above the level that would prevail without the merger.

X33. We found no evidence to indicate that Chevron provided a stronger constraint than any other bidder, such that its removal from the market would mean that prices would rise post-merger.

X34. All of the major fuel firms have an established presence throughout New Zealand and have the ability to expand the amount of diesel they supply directly to bulk commercial customers. For these bulk customers, Z would be constrained by the presence of both BP and Mobil.

X35. For bulk customers supplied by resellers, Z and its related resellers would be constrained by the presence of resellers supplied by BP and Mobil.

The supply of diesel to commercial customers at truck stops

X36. Each of the major fuel firms has a network of truck stops that spans the country, though the locations of their truck stops vary geographically. At a national level and at different regional and local levels, we consider that post-merger Z would be constrained by the presence of BP and Mobil's truck stop networks or one of Mobil's related resellers, except in one local area – Kawerau.

X37. Z and Chevron currently operate the only truck stops in Kawerau and, post-merger, local Kawerau truck stop customers would have no alternative to the merged entity.

X38. The divestment undertaking provided by Z remedied our concerns in Kawerau.

The supply of marine fuel

X39. All marine fuel supplied in New Zealand is produced at the refinery and the market is best characterised as a bidding market, where customers use competitive tender processes to obtain competitive prices.

X40. Given that Chevron is not a significant competitor in the supply of marine fuel, we consider that its removal from the market would not alter any existing market power held by Z. Post-merger, BP and Mobil would remain as alternatives to Z in the supply of marine fuel.

The proposed merger

Summary of the proposed merger

1. On 1 July 2015, the Commerce Commission (the Commission) registered an application under s 66(1) of the Commerce Act 1986, for Z Energy Limited (Z), to acquire 100% of the shares in Chevron New Zealand (Chevron) (the Application).

2. On 28 April 2016, Z provided the Commission with a divestment undertaking (the undertaking, see Attachment A) to remedy any substantial lessening of competition arising from the proposed merger. The undertaking provides that Z will divest 19 service stations and one truck stop. We consider the competition effects of the undertaking in the proposed divestment section.

Our decision

3. We give clearance to the proposed merger, subject to the undertaking, as we are 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. This includes markets for the supply of:

    3.1. terminal storage facilities;

    3.2. fuel to retail customers through services stations, subject to 19 divestments;

    3.3. bitumen;

    3.4. aviation fuel;

    3.5. petroleum products to commercial customers;

    3.6. diesel to commercial customers at truck stops, subject to one divestment; and

    3.7. marine fuel.

4. However, Dr Walker is not satisfied that the proposed merger would not increase the ability of the remaining fuel firms to coordinate on retail pricing. As such, she has dissented (for the reasons set out in her dissenting opinion attached to this determination).

Our framework

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

The substantial lessening of competition test

6. As required by the Commerce Act 1986, we assess acquisitions using the substantial lessening of competition test.

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

7. We determine 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]

8. 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.

9. 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.

10. Determining the scope of the relevant market or markets can be a useful tool in determining whether a substantial lessening of competition is likely.

11. We define markets in the way that we consider best isolates the key competition issues that arise from the acquisition. 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 1986, as a matter of fact and commercial common sense.[4]

When a lessening of competition is substantial

12. 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] A substantial lessening of competition in a significant section of a market, may, according to circumstances, be a substantial lessening of competition in a market.[7]

13. Consequently, 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.

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

3 Or below competitive levels in a merger between customers.

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 *Dandy Power Equipment Pty Ltd & Anor v Mercury Marine Pty Ltd* (1982) 64 FLR 238, 260; 44 ALR 173, 192; ATPR 40-315, 43,888, cited with approval by McGechan J in *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 at 435.

When a substantial lessening of competition is likely

14. 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.[8]

The clearance test

15. We must clear an acquisition if we are satisfied that the acquisition would not be likely to substantially lessen competition in any market.[9] If we are not satisfied – including if we are left in doubt – we must decline to clear the acquisition.[10] It is open to us to say: "We are not sure and therefore we are not satisfied that there will be no substantial lessening of competition".[11]

16. The burden of proof lies with Z, 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.[12] The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence.[13] We will sometimes have before us conflicting evidence from different market participants and must determine what weight to give to the evidence of each party.[14]

Key parties

Z

17. Z is a publicly-listed company, listed on the New Zealand and Australian stock exchanges.

18. Z was formed following the purchase of Shell's New Zealand downstream business by Infratil Limited and the Guardians of the New Zealand Superannuation Fund in 2010. In 2011 the company and service stations were rebranded as Z. Z was listed on the New Zealand and Australian stock exchanges in 2013.

19. Z is a supplier of petroleum products in New Zealand and has interests throughout the supply chain from refining to retailing.

    19.1. Z has a 15% shareholding in The New Zealand Refining Company Limited (NZRC) that operates the oil refinery at Marsden Point.[15] It has a processing agreement with NZRC that gives it a right to a proportion of its capacity.

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8 *Woolworths & Ors v Commerce Commission* (HC) above n5 at [111].

9 Section 66(1) of the Commerce Act 1986.

10 In *Commerce Commission v Woolworths Limited* (CA), above n2 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".

11 *Commerce Commission v Woolworths Ltd* (CA) above n2 at [207(a)].

12 *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7] and *Commerce Commission v Woolworths Ltd* (CA) above n2 at [97].

13 *Commerce Commission v Woolworths Ltd* (CA) above n2 at [101].

14 *Brambles New Zealand Ltd v Commerce Commission* above n4 at [64].

15 Clearance Application from Z (30 June 2015) at [69].

19.2. Z is a joint-owner with Chevron, BP and Mobil (together with Z the major fuel firms) of a coastal shipping operation, Coastal Oil Logistics Limited (COLL), that distributes fuel from the refinery to ports around New Zealand.

20. Z owns fuel storage terminals, pipelines, and truck loading facilities used for the distribution of fuel around New Zealand.

21. Z owns a network of truck stops and service stations located throughout New Zealand.

22. These assets are used to supply petroleum products to commercial and retail customers. This includes the supply of petrol, diesel, aviation fuel, marine fuel and bitumen.

23. Z has wholesale supply arrangements for petrol and diesel with Southfuels Limited (Southfuels).[16] Southfuels supplies bulk fuel throughout New Zealand and also operates around 8 service stations.[17]

Chevron

24. Chevron is a wholly-owned subsidiary of Chevron South Asia Holdings Pte Limited, based in Singapore.

25. Chevron is also a supplier of petroleum products with interests throughout the supply chain.

25.1. Chevron previously held a shareholding in NZRC. However, Chevron sold its interest prior to the Application.[18] It continues to have a processing agreement with NZRC for the right to capacity.

25.2. Chevron is a joint-owner in COLL.

25.3. Chevron owns fuel storage terminals, pipelines, and truck loading facilities used for the distribution of fuel around New Zealand.

25.4. Chevron owns a network of truck stops located throughout New Zealand. Chevron does not generally own service stations but instead supplies a network of owner-operated service stations under the Caltex banner on long term supply agreements. Chevron also owns the Challenge brand under which there are more owner-operated service stations. Caltex and Challenge service stations are located throughout New Zealand.

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16 Southfuels and other resellers (discussed in turn below), tend to be closely aligned with one of the major fuel firms. All the main resellers are in long term contracts with one of the major fuel firms and, in the past, there has been limited examples of resellers switching between the major fuel firms.

17 The service station and truck stop site figures cited in this determination were current as at the date when we collected data from industry participants. Due to the opening and closing of sites, the figures may not be current as at the date of publication of this determination.

18 Clearance Application from Z (30 June 2015) at [69].

26. These assets are used to supply petroleum products to commercial and retail customers. This includes the supply of petrol, diesel, aviation fuel, marine fuel and bitumen.

27. Chevron has wholesale supply arrangements for petrol and diesel with Farmlands Co-operative Society Limited (Farmlands) and McKeown Group Limited (McKeown). Both Farmlands and McKeown supply bulk fuel throughout New Zealand. Farmlands supplies fuel to the network of around 81 Challenge service stations on a wholesale basis. McKeown also operates around 18 unmanned sites.

Other major fuel firms

28. Z and Chevron are two of the major fuel firms operating in New Zealand. The other major fuel firms are Mobil Oil New Zealand Limited (Mobil) and BP Oil New Zealand Limited (BP).[19]

29. Mobil is a supplier of petroleum products with interests throughout the supply chain. Mobil supplies petrol, diesel, aviation fuel, and marine fuel but does not supply bitumen.

    29.1. Mobil has a 17% shareholding in NZRC[20] and a processing agreement. Mobil is part of the COLL joint venture. Mobil owns terminals, pipelines and other assets used for distributing fuel.

    29.2. Mobil has a truck stop and service station network operating under the Mobil banner located throughout New Zealand. Its Mobil-branded service stations are a mix of company-owned and owner-operated stations supplied on a wholesale basis.

    29.3. Mobil has a contract to supply fuel to Foodstuffs[21] service stations. Foodstuffs has a network of around 49 unmanned service stations located beside its supermarkets.

    29.4. Mobil has wholesale supply arrangements for petrol and diesel with resellers including Allied Petroleum Limited (Allied), Wealleans Allied Petroleum Limited (Wealleans), Waitomo Petroleum Limited (Waitomo) and Nelson Petroleum Distributors Limited (NPD). All supply bulk fuel to customers and operate truck stops and service stations. Allied operates throughout New Zealand, Wealleans and Waitomo operate in the North Island, and NPD is mainly at the top of the South Island. Across New Zealand, there are around 71 Allied, 25 NPD, 22 Waitomo and 1 Wealleans site(s).

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19 In this determination, we collectively refer to Z, Chevron, BP and Mobil as the major fuel firms.

20 Clearance Application from Z (30 June 2015) at [69].

21 Foodstuffs is a nationwide supermarket operator with almost 190 New World and Pak'nSave stores across New Zealand. Each store is independently owned and operated, with store owners being members of either Foodstuffs North Island Limited or Foodstuffs South Island Limited, depending on the location of a store.

30. BP is a supplier of petroleum products with interests throughout the supply chain. BP supplies petrol, diesel, aviation fuel, and marine fuel but does not supply bitumen.

    30.1. BP has a 21% shareholding in NZRC[22] and a processing agreement. BP is part of the COLL joint venture. It owns terminals, pipelines and other assets used for distributing fuel.

    30.2. BP has a truck stop and service station network operating throughout New Zealand under the BP banner. Its stations are a mix of company-owned and owner-operated stations supplied on a wholesale basis. BP has a contract to supply fuel to the Gasoline Alley Services Limited (GAS) retail network. GAS has a network of around 123 owner-operated service stations throughout New Zealand, although most are concentrated around Auckland.

    30.3. BP has wholesale supply arrangements for petrol and diesel with resellers including Aratuna Freighters Limited (Aratuna), RD Petroleum Limited (RD), Rural Fuel Limited (Rural Fuel), McFall Fuel Limited (McFall) and Toll (New Zealand) Limited (Toll). BP has ownership interests in RD (49% ownership), McFall (30% ownership) and Rural Fuel (100% ownership). Each operates on a regional basis and collectively cover all of New Zealand: Aratuna (West Coast), RD (South Island other than the West Coast), Rural Fuel (lower North Island), McFall (central North Island) and Toll (upper North Island). RD and Rural Fuel also operate truck stops and service stations, operating around 14 and 1 site(s), respectively.

31. Gull New Zealand Limited (Gull) is a supplier of petrol and diesel through its network of service stations. Gull also supplies commercial customers. Gull's only storage facility is located at Mt Maunganui. Gull supplies almost all of its service stations from that facility. Gull's network is concentrated around the Auckland, Waikato and Bay of Plenty regions. However, it has an outlet as far north as Whangarei and as far south as Masterton. Gull does not have a processing agreement with NZRC and instead tenders for refined fuel supply internationally.[23] [24]

NZRC

32. NZRC owns and operates New Zealand's only oil refinery at Marsden Point. The refinery receives shipments of crude (owned by the major fuel firms) and then refines them into the various petroleum products. There is a separate unit for processing bitumen.

33. NZRC is a publicly listed company. Its shareholders include BP, Mobil and Z. Chevron held an interest in NZRC but sold it prior to the Application.[25] [26]

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22 Clearance Application from Z (30 June 2015) at [69].

23 Ibid at [40].

24 Gull's current supplier is Exxon Mobil in Singapore. The vast majority of Gull's fuel needs are imported from Asian refineries, [ ]. Commerce Commission interview with Gull (4 September 2015).

25 Clearance Application from Z (30 June 2015) at [69].

34. NZRC has a processing agreement with each of the major fuel firms which gives them the right to a certain proportion of the refinery's capacity. Under these agreements, each fuel firm retains ownership of the crude and the resulting output, and NZRC charges a fee for converting the crude into refined products.

35. NZRC produces fuel to supply the majority of New Zealand's domestic demand. The proportion however varies by product: it produces 70% of the domestic market's petrol, 84% of the diesel, 83% of the aviation (jet) fuel, 100% of the marine fuel and 75% of bitumen.[27] These refined products are then distributed throughout New Zealand via coastal shipping and the Refinery-to-Auckland (RAP) pipeline (the pipeline also being owned by NZRC). The remainder of the domestic markets' requirements are imported and any surplus produced by the refinery (usually marine fuel) is exported.

COLL

36. COLL is a joint venture between the major fuel firms. It organises the logistics of supplying terminals throughout the country. This includes:

    36.1. scheduling coastal shipping to transport fuel domestically refined at Marsden Point to terminals throughout New Zealand. COLL is responsible for assessing capacity utilisation at each terminal to ensure terminals do not run out of fuel;[28] and

    36.2. scheduling imports to ensure import deliveries do not conflict with coastal shipping deliveries of domestically refined fuel.

37. The costs of COLL are shared by the major fuel firms based on each firm's usage. COLL operates at capacity to maximise efficiency.[29]

Industry background

38. The proposed merger relates to the refining, distribution, storage and supply of petroleum products to commercial and retail customers. Before analysing the impact of the proposed merger on specific markets, we provide an overview of the refining, distribution and storage of petroleum products in New Zealand.

Types of refined fuel supplied in New Zealand

39. The types of refined fuel products supplied in New Zealand include petrol, diesel, aviation fuel, marine fuel and bitumen.[30] Table 1 summarises the approximate

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26 Chevron sold its interest in NZRC to independent parties in June 2015. Letter from Buddle Findlay (on behalf of Chevron) to the Commission (29 June 2015).

27 http://www.refiningnz.com/visitors--learning.aspx.

28 Schedule 1 to COLL Joint Venture Agreement (29 November 2007) and Shared Stock Arrangements Principles (1 October 2007).

29 Commerce Commission interview with COLL (16 October 2015).

30 Other products include LPG, kerosene and industrial lubricants. The proposed merger raised no competition issues for the supply of these products. In the case of LPG, this was because Z does not currently supply LPG. In the case of kerosene and industrial lubricants, while Z and Chevron both supply these products, there are a number of other suppliers.

volumes of these products consumed in New Zealand per annum and the major consumers of those products.

Table 1: Refined products

Refined product	Approx market size[31]	Customers
Petrol	3,034 million litres	Retail consumers
Diesel	2,963 million litres	Transport, manufacturing, construction companies and retail consumers
Aviation fuel	1,272 million litres	Airlines
Marine fuel	0.466 million litres	Freight, fishing, ferry, cruise lines
Bitumen	160-180 kilo tonnes	Roading companies

Source: Z Investment Statement and Prospectus (25 July 2013) and Z "Bitumen strategy" (14 July 2014)

40. There are two sources of refined products for fuel firms: that processed from crude oil at NZRC's Marsden Point refinery and imported refined product.

41. Fuel firms cannot choose to have a barrel of crude processed into only one or two petroleum products. Instead, each barrel of crude refined by NZRC at Marsden Point produces a mix of different refined products, including petrol, diesel, aviation fuel and other products. This is known as the "butchery principle" and is illustrated in Figure 1. Although the ratio of these different products produced from a barrel of crude are fixed for the most part, there is some degree of flex between different fuel types at the margins.

Figure 1 – Outputs from a typical barrel of crude oil

Source: Clearance Application from Z (30 June 2015) at 20

[31] Figures are for 2013 except bitumen for 2014.

42. The refined fuel produced at Marsden Point is distributed to terminals throughout the country using coastal shipping and pipelines. This is known as "primary distribution" and is illustrated in Figures 2 and 3.

Figure 2: Production and primary distribution of fuel products

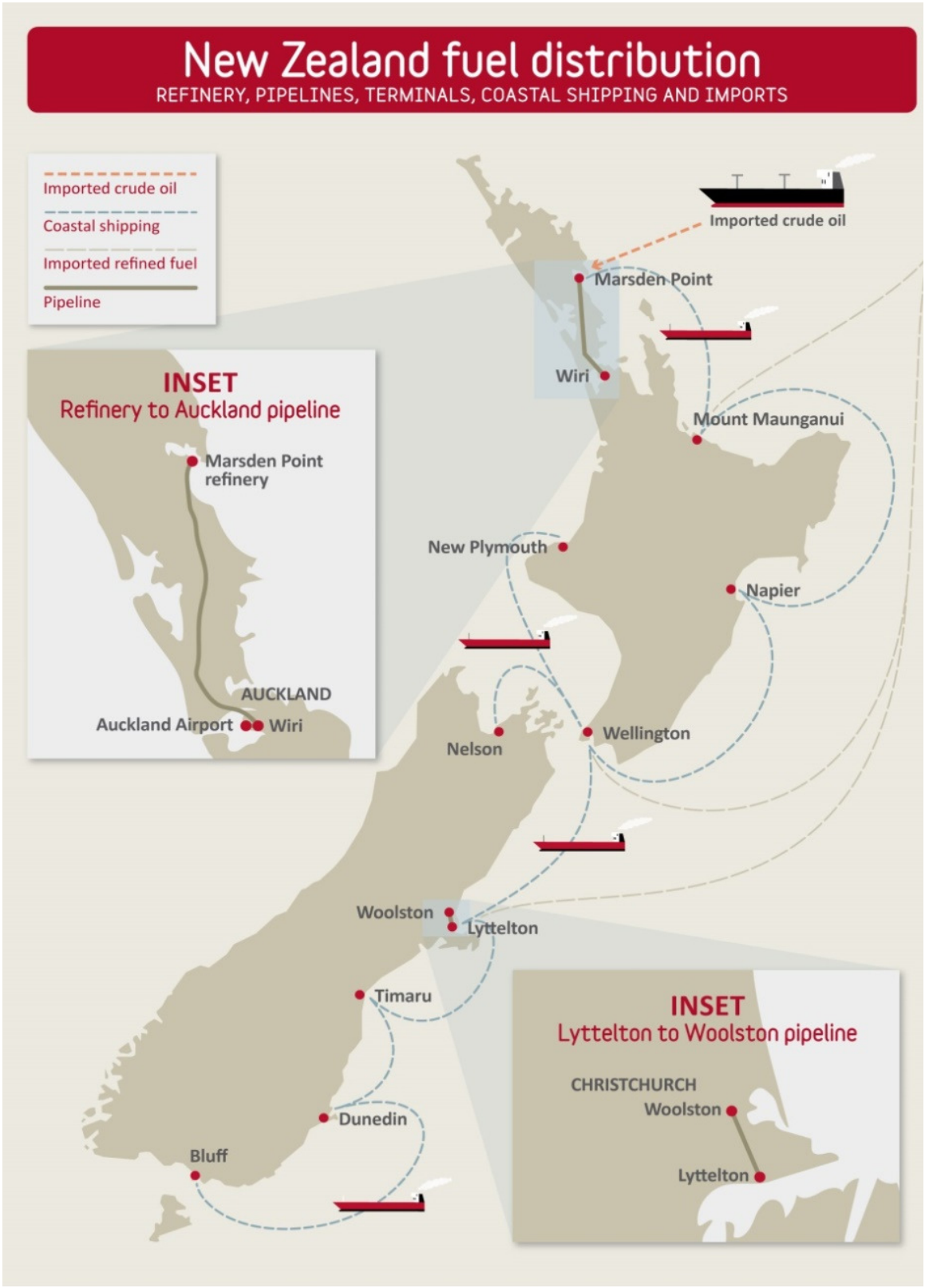
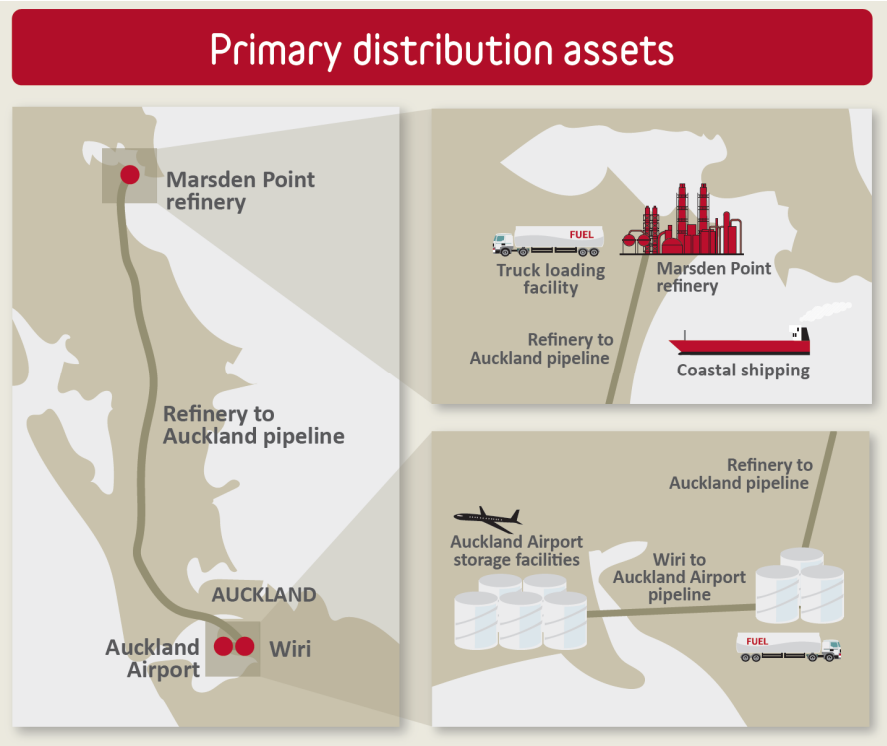


Figure 3: Primary distribution assets in Marsden Point and Auckland



43. Around 37% of the refined fuel produced at the refinery is delivered to the Wiri Terminal via the RAP.[32] This is used to service Auckland and surrounding areas. The remaining fuel is distributed by COLL using coastal shipping. The coastal vessels, the Kakariki and the Torea, have compartments for each type of refined fuel.[33] The vessels fill up at Marsden Point then make their way down the coast making drops at each port where there are terminals.

44. Generally, imported fuel arrives at three ports in New Zealand: Mt Maunganui, Wellington and Christchurch.

45. From the terminals, refined products are further distributed by road using fuel tankers or by pipeline.

    45.1. Auckland Airport is supplied all of its aviation fuel requirements directly from the Wiri Terminal via the Wiri-to-Auckland Airport (WAP) pipeline.

    45.2. The Woolston pipeline transports fuel from Lyttelton to terminals at Woolston.

The refinery

46. As discussed above, each of the major fuel firms has a processing agreement with NZRC. These agreements determine how processing capacity is allocated between the major fuel firms and the processing fee that each is required to pay NZRC for its refining services.

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32 Clearance Application from Z (30 June 2015) at [87.1].

33 Only one of the coastal vessels (the Kakariki) has a compartment for bitumen.

47. Each major fuel firm is allocated capacity at the refinery in proportion to its respective aggregated three-year rolling average market share in terms of downstream refined products.[34] This means that a refinery user wishing to grow its downstream market share would initially need to do so through importing refined product. For bitumen processing capacity, the calculation is based on downstream bitumen sales only.[35]

48. The fee that each refinery user is required to pay NZRC is based on 70% of the refinery's "Gross Refining Margin" (the GRM). The GRM is a proxy for the value of using the refinery instead of importing refined products and is calculated as the difference between the benchmarked cost of importing and landing crude oil, and the benchmarked cost of importing and landing refined product.[36] This calculation is designed to incentivise the major fuel firms to maximise the use of the refinery.[37] The 30% that the user retains from the GRM is designed to reflect the costs that are incurred by the major fuel firms rather than the refinery, such as the cost of coastal shipping and working capital associated with stockholding crude.

49. Each user also receives a volume based discount on processing fees. The volume based discount may differ for each user as it is determined bilaterally between the user and NZRC.[38]

50. A Technical Committee, comprising one representative from each refinery user and one representative from NZRC, carries out the allocation of users' capacities, and reviews technical aspects of the refinery's operation. Technical Committee decisions are made by consensus.[39]

51. As a result of the proposed merger, Z would move from having approximately [ ]% to approximately [ ]% of allocated processing capacity at the refinery. We do not consider that the merged entity's increase of capacity allocation would substantially lessen competition in the market for refinery services.

52. Z would not otherwise gain any ability to worsen others' terms of access to the refinery. Technical Committee decisions would continue to be made by consensus. Z would also not gain any additional influence over the board of NZRC as Chevron is no longer a shareholder in NZRC.

53. However, industry participants' access to, and use of, the refinery remains relevant to our assessment of competition in other downstream markets (for example, markets relating to aviation fuel, marine fuel, bitumen, and commercial and retail sales of petrol and diesel). We address the relevance of the refinery to those markets separately in the relevant sections later in this determination.

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34 Clearance Application from Z (30 June 2015) at [73].
35 Users' processing agreements with NZRC.
36 Clearance Application from Z (30 June 2015) at [76].
37 Ibid at [77].
38 Commerce Commission interview with NZRC (25 August 2015).
39 Users' processing agreements with NZRC, Article XVIII.

Primary distribution

54. Refined fuel is distributed around New Zealand through primary distribution assets, including pipelines, storage terminals and coastal shipping assets.[40] Most of the primary distribution assets (except for storage terminals) are jointly owned by the major fuel firms. An exception is the RAP which is owned by NZRC.

55. The jointly owned primary distribution assets are summarised at Table 2.

Table 2: Summary of jointly owned primary distribution assets

Primary distribution asset	Description	Pre-merger ownership	Operator
Wiri Terminal	Fuel storage terminal at Wiri, Auckland	BP: 27.78%[41] Chevron: 16.67% Mobil: 27.78% Z: 27.78%	Wiri Oil Services Limited (WOSL)[42]
WAP	Pipeline for distributing aviation fuel between the Wiri Terminal and fuel storage facilities at Auckland Airport	BP: 20% Chevron: 40% Mobil: 20% Z: 20%	WOSL
Truck loading facilities at refinery	Truck loading facilities at the refinery, from which fuel is trucked to commercial customers and retailers in the Northland region	BP: 25% Chevron: 25% Mobil: 25% Z: 25%	WOSL
Coastal shipping assets	Coastal shipping vessels deliver refined fuel from the refinery to storage terminals at ports around New Zealand	BP: 25%[43] Chevron: 25% Mobil: 25% Z: 25%	COLL
Auckland Airport joint storage facilities	Jointly owned aviation fuel storage and administration facilities at Auckland Airport	BP: 25% Chevron: 25% Mobil: 25% Z: 25%	One of BP, Chevron, Mobil and Z is appointed as the operator on a rotational basis[44]

Source: Clearance Application from Z (30 June 2015) and joint venture agreements between primary distribution asset owners

56. The jointly owned primary distribution assets are operated on a cost recovery basis. That is, the costs of their operation are allocated to their owners, typically based on each party's proportion of use, and they are not operated on a profit making basis.[45]

57. For reasons we discuss below, we do not have concerns over the impact that the proposed merger would have on any market for services that the primary distribution assets provide.

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40 We consider terminals other than the terminal at Wiri separately in the section on the supply of terminal storage facilities.

41 Includes 11.11% ownership share of Europa Oil (NZ) Limited, which is a BP subsidiary.

42 WOSL operates some of the primary distribution assets using its own employees, but does not itself own any of the assets. It is jointly owned by BP (27.78%), Mobil (27.78%), Z (27.78%) and Chevron (16.67%).

43 Clearance Application from Z (30 June 2015) at [97].

44 Ibid at [142.1].

45 Schedules 1 and 2 to COLL Joint Venture Agreement (29 November 2007), NEWSPEED Model Principles (1 October 2007) and joint venture agreements between primary distribution asset owners.

58. However, understanding how the primary distribution assets operate remains relevant to our consideration of the downstream markets. BP and Mobil rely on these assets to supply fuel to downstream markets. If Z's increased interest in the primary distribution assets makes it difficult or costly for BP and Mobil to increase volumes, it may affect their response to post-merger price increases.

59. We do not have concerns over the impact of the proposed merger on the primary distribution assets because we do not consider that Z's influence over the assets would increase in a way that would materially affect BP or Mobil's access to such assets.[46] The relationship between underlying ownership and operational control is determined by separate agreements, including joint venture agreements that exist in relation to each of the assets, which Z could not override post-merger.[47]

    59.1. Key matters relating to each of the assets are determined by unanimous decision-making.[48] Post-merger, Z would still require BP and Mobil's agreement to pass unanimous decisions. Pre-merger, each of the participants already has negative control over unanimous decisions, so Z would also not gain any negative control from the proposed merger (that is, the ability to block decisions).

    59.2. Where there are instances of majority decision-making, we do not have concerns as these do not relate to matters that would materially affect BP or Mobil's access to such assets.[49] We also do not consider that Z gaining any negative control over such decisions post-merger would allow it to materially affect BP or Mobil's access to such assets.

    59.3. In addition, pre-emptive rights exist in favour of BP and Mobil in relation to the joint storage facilities at Auckland Airport and the WAP. If these are exercised, then BP, Mobil and Z would each own a third share of those assets, alleviating any concerns over Z increasing its ownership share. While the pre-emptive rights have not yet been triggered, if BP or Mobil decided not to exercise them, this would indicate that they do not consider themselves at risk as a result of Z's increased ownership of those assets.

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46 BP and Mobil did not express significant concerns regarding their access to the primary distribution assets post-merger.

47 For example, a party's underlying ownership of the Wiri Terminal land does not allow it to influence the Wiri Terminal's operation as the land is leased to NZRC and subleased to WOSL, with both the lease and sublease going through to 2025. WOSL operates the Wiri Terminal under unanimous decision-making. Post-merger, Z could not by itself terminate the lease or sublease, or remove WOSL as the operator. Similarly, the mechanisms for key matters relating to the WAP such as cost allocation, additions or alterations to the pipeline and admission of new parties are set out in the Wiri Pipeline Operating Agreement, and would require unanimous agreement to amend.

48 For example, the mechanisms for allocating operating costs to users of the truck loading facilities, the WAP and the Auckland Airport joint storage facilities, and ongoing changes to coastal shipping schedules.

49 Examples of matters where there is majority decision making include one-off changes to coastal shipping schedules and determining the design and components of alterations to the joint storage facilities at Auckland Airport.

The borrow and loan system

60. To avoid duplication of primary distribution assets, the major fuel firms share the use of each other's terminal assets. Each of the major fuel firms has terminals at various ports, although not necessarily at every port or for every refined product. In all but one of the locations (Wellington), the terminals are independently owned by each of the fuel firms. In Wellington, BP and Z jointly own three terminals.

61. Under a borrow and loan system, the participants' terminals are declared as industry storage, and the refined product held within the terminals is jointly owned by the participants. This means that any of the participants are able to draw down product from one another's terminals without having to buy or sell that product. A fuel firm may draw down as much refined product as it wishes. However, it must ensure that it contributes the same amount to the system, either through fuel that it has had domestically refined or through importing. The borrowing and lending is accounted for by COLL. If a fuel firm has borrowed more product than it has contributed to the system, COLL requires that firm to contribute more product to reduce the deficit.[50]

62. There are some terminals that the major fuel firms own that are not within the borrow and loan system, namely:

    62.1. Z and BP have taken their respective marine terminals at Nelson outside of the borrow and loan system;

    62.2. Z, BP and Mobil have some privately owned terminals for some imported products that are not manufactured at the refinery. Most notably, Avgas and 98-octane petrol; and

    62.3. the Wiri Terminal and Marsden Point terminals that are jointly owned by all four of the fuel firms are not part of the borrow and loan system. Rather, at these terminals the fuel firms can only draw down what they contribute.[51]

63. Although there is no transaction at a terminal for the refined product, the owner of a terminal charges a throughput fee to other participants of the shared system that draw down product from its terminal. Throughput fees are charged on a cent per litre (cpl) basis and are paid by the fuel firm who draws down the product, rather than by any reseller or third-party distributor that is responsible for physically delivering the product.[52]

64. Gull also owns storage terminals at Mt Maunganui. However, Gull does not participate in the major fuel firms' borrow and loan system.[53]

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50 COLL Joint Venture Agreement (29 November 2007) and Shared Stock Arrangements Principles (1 October 2007).

51 These assets have been considered in the primary distribution section.

52 Commerce Commission interview with Chevron (26 August 2015), Commerce Commission interview with Mobil (26 August 2015) and Commerce Commission interview with BP (26 August 2015).

53 Clearance Application from Z (30 June 2015) at [107].

With and without scenarios

With the merger

65. With the proposed merger, Z would acquire all the shares in Chevron and all the rights and liabilities that attach to them. Chevron would become a wholly-owned subsidiary of Z.

Without the merger

66. Z submitted that without the proposed merger, the Chevron business would continue to operate independently of Z, although potentially under different ownership.[54] Accordingly, we have analysed the proposed merger on the basis that the without-the-merger scenario is the status quo.

67. An exception is for the supply of bitumen. Due to our conclusion that Chevron intends to exit the bitumen market in New Zealand without the merger, we do not use the status quo for the without-the-merger scenario. Instead, we have analysed the market for bitumen on the basis that Z would be the only major supplier of bitumen in New Zealand with or without the merger. This is further explained in the bitumen section.

The supply of terminal storage facilities

68. This section deals with the impact of the proposed merger on the supply of terminal storage facilities.

69. Post-merger, Z would own and control a greater proportion of terminal storage facilities (terminals) at ports around New Zealand. For example, Z would own all of the terminals at Timaru and almost all of the terminals at Nelson (the areas of overlap are set out in Figure 4).[55]

70. Despite this, we consider that the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition in the supply of terminal services in any regional market. In all terminal markets under consideration we concluded that Z would be constrained from substantially raising throughput fees because BP and Mobil either can supply themselves or could retaliate against Z elsewhere by increasing the price for, or limiting, access to their terminals. As a consequence, we do not consider that the proposed merger of Z and Chevron's terminal facilities would impact on BP and Mobil's ability to compete in related downstream markets.

71. In addition, even if Z increased Chevron's throughput fees [ ], we consider that this would not be likely to affect BP and/or Mobil's ability to compete in related downstream markets. This is because BP and Mobil would both be able to offset the effects of any throughput fee increase by retaliating against Z, so that Z's increase of Chevron's throughput fees would likely

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54 Ibid at [32].

55 Post-merger, Z would also own all of the 95-octane petrol terminals at Mt Maunganui that are within the borrow and loan system. However, at Mt Maunganui Gull is also an option for 95-octane storage.

result in a relatively insignificant overall net cost increase or a net gain to BP and/or Mobil. Further, even if there was an effect on downstream prices, it is unlikely to be substantial.

Background

72. Refined products are delivered to, and stored in, terminals until dispensed for use in downstream markets. Typically, terminals consist of one or more storage tanks with an attached dispensing mechanism, either a gantry or a bunker pipeline (or both). Gantries are used to pump product into tanker trucks for inland delivery. Bunker pipelines are used to pump product directly into ships.

73. In general, terminals are located at coastal ports, although a notable exception is Mobil's inland terminal at Woolston in Christchurch. The Woolston terminal services the Christchurch region and is connected to terminals at the port of Lyttelton via a Mobil owned pipeline over the Port Hills. The pipeline is the most efficient way of transporting product from the port of Lyttelton to inland Christchurch.[56]

74. Each of the major fuel firms own terminals at various ports, although not necessarily at every port or for every refined product. The major fuel firms have access to each other's terminals under the borrow and loan system discussed above.

75. All of Chevron's individually owned terminals are within the borrow and loan system.

Throughput fees

76. As outlined above, although there is no transaction at the terminal for the product, the owner of a terminal charges a throughput fee to any other participant of the borrow and loan system that draws down product from its terminal.

77. Throughput fees are either set unilaterally by the terminal owner or as a result of bilateral negotiation. They vary across owners and across ports. Throughput fees set by bilateral negotiation are fixed for a period of time and typically involve an agreed starting price with scope for annual adjustments to account for inflation.[57] In theory, throughput fees that are not subject to one of these agreements can be changed at any time. However, typically they are reviewed annually by the owner of the terminal.

78. Where possible, fuel firms draw down product from their own terminals rather than from a rival fuel firm's terminal. This is because fuel firms would prefer to maximise the throughput of their own terminals rather than contributing revenue to assist their rivals in recovering terminal costs.

How the proposed merger could substantially lessen competition

79. Post-merger, Z would own and control a greater proportion of terminals at ports around New Zealand. The areas of overlap are illustrated in Figure 4.

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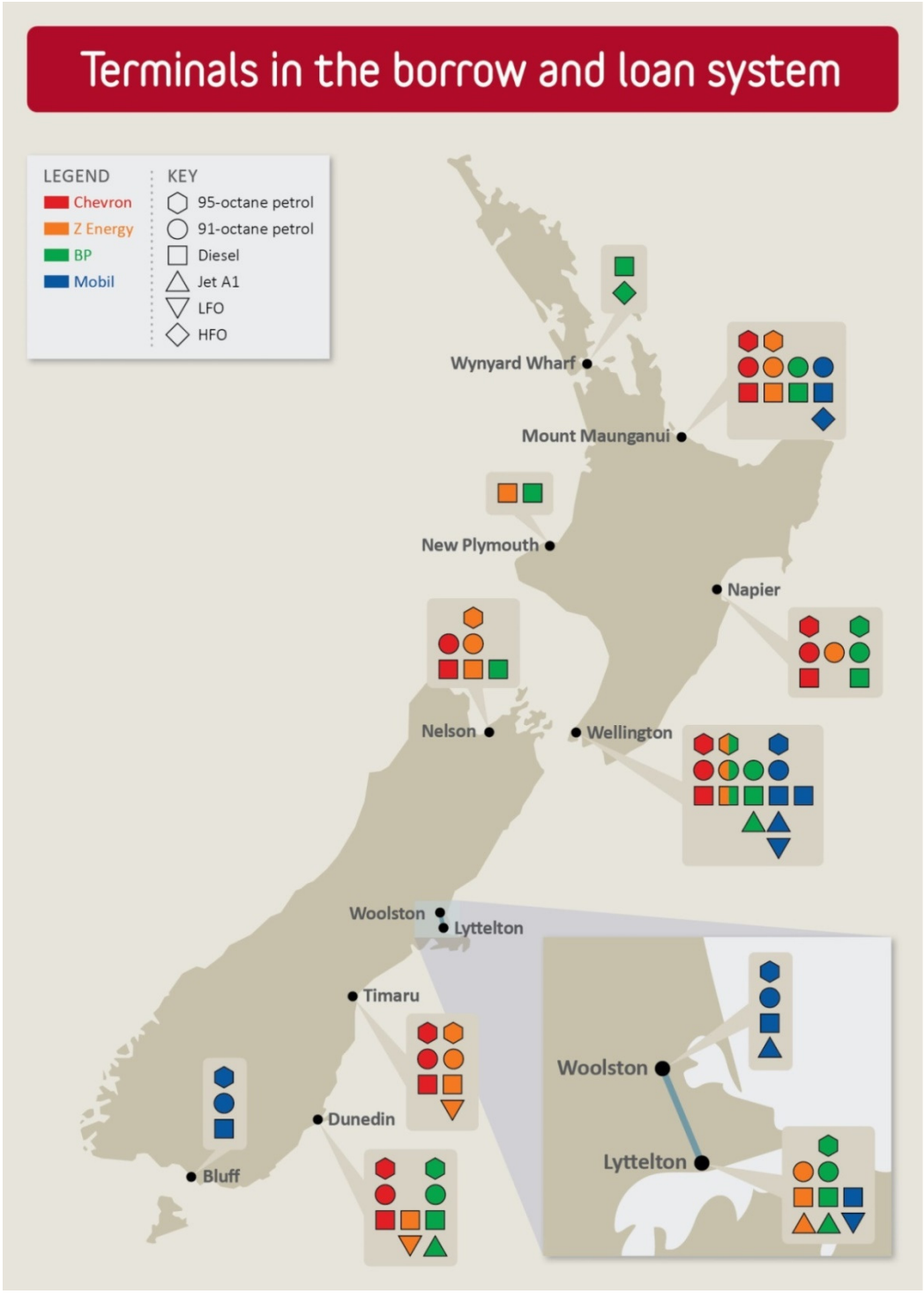
[56] Clearance Application from Z (30 June 2015) at [124].

[57] This is often referenced to the consumer price index.

Figure 4: Location and ownership of storage terminals within the borrow and loan system, post-merger



Source: Industry participants

80. We have assessed whether the aggregation of Z and Chevron's terminals would enable Z to unilaterally increase the throughput fees charged to BP and/or Mobil post-merger. If that occurred, this could not only constitute a substantial lessening of competition in terminal markets, it could also impact related downstream markets since it would increase BP and/or Mobil's terminal costs.

81. In assessing the magnitude of any potential throughput fee increase, we have looked at the likelihood of Z increasing BP and/or Mobil's throughput fees anywhere up to the cost of the next best supply alternative. This includes whether
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Market definition

82. We have defined separate markets for the storage of each refined product and for each geographic location. In addition, we have also considered the dynamics of the borrow and loan system as a whole. This is because the borrow and loan system is accounted for nationally, and therefore, when making a decision in any terminal market, the major fuel firms take into consideration the possibility and consequences of retaliation across the borrow and loan system.

Product dimension

83. We consider that there are separate markets for the storage of each refined product (including for different types of petrol, for example 95-octane petrol and 91-octane petrol). We have reached this view based on the limited ability for fuel firms to easily switch the type of fuel that is stored in a terminal.

Geographic dimension

84. We consider that the relevant geographic markets for considering the competition effects of the proposed merger are regional, by terminal location. We have reached this view based on the limited ability for customers to switch between terminals at different locations.

85. Although refined product can be trucked from a terminal in one location to a terminal in another, there is significant cost involved. We consider that the distance between New Zealand's terminal locations is such that a small but significant increase in throughput fees would not be constrained by trucking product from another port.[58]

Competition analysis

86. Post-merger, Z would control more 95-octane petrol, 91-octane petrol and diesel terminals at a number of terminal locations (see Figure 4).

87. In particular, at Timaru and Nelson, the aggregation would be such that Z would not face significant competitive constraint from within those areas. This is because the merged entity would own all of the terminals at Timaru and almost all of the terminals at Nelson.[59]

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58 For the purposes of this assessment, we consider that this is also the case between the Lyttelton and Woolston as there are restrictions on trucking some refined products through the Lyttelton tunnel.

59 Post-merger, Z would also own all the 95-octane terminals at Mt Maunganui that are within the borrow and loan system. However, Gull also owns a 95-octane terminal at Mt Maunganui and sells product from this terminal to some of the major fuel firms.

88. However, we have assessed whether BP and/or Mobil could effectively constrain Z from exercising any regional market power by retaliating against Z in other terminal markets where BP and/or Mobil either have, or would be likely to have, regional market power. For example, if Z increased its throughput fees at Timaru or Nelson, BP and/or Mobil could raise their own throughput fees to Z, or deny access to Z, at other terminals where Z is reliant on BP and/or Mobil for terminal storage capacity.

Z's submissions

89. Z submitted that it would be unable to unilaterally increase throughput fees to BP and Mobil in any terminal market because of BP and Mobil's ability to retaliate by increasing throughput fees in other terminal markets where Z is dependent on them for product with no viable alternatives. Z submitted that because it would be more dependent on BP and Mobil's terminals post-merger, it would be worse off in the borrow and loan system if it were to increase throughput fees to BP and Mobil and they were to retaliate.[60]

90. Z also claimed that it does not focus on trying to maximise throughput fee revenue in-and-of itself.[61] Rather, it says that its throughput fees are set to recover operating and capital costs, including forward looking replacement costs.[62] Z submitted that setting throughput fees above cost would jeopardise the co-dependent nature of the borrow and loan system, adding significant risk. This risk includes triggering a break-up of the entire system and negatively affecting commercial relationships with BP and Mobil in upstream joint ventures.[63]

91. We consider that Z's submissions are largely consistent with our observations of the historical setting of throughput fees.
[[64]]
Similarly, fuel firms do not appear to take advantage of periods of temporary market power, for example when a competitor's terminal is closed for repairs or maintenance.

Does BP have the ability to constrain Z from increasing throughput fees?

92. Z provided us with a model that estimates the level of dependence between Z and BP terminals post-merger.[65] This model allowed us to estimate the costs to BP and a merged Z if they were to increase throughput fees to each other. Our estimates of

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60 Letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (10 December 2015) and letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (4 March 2016).

61 Commerce Commission interview with Z (18 February 2016) and Commerce Commission interview with Z (23 February 2016).

62 Commerce Commission interview with Z (17 March 2016).

63 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (23 October 2015) at [17].

64 [ ]

65 Annex 1 of submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (4 March 2016). This model was subsequently updated and resubmitted as Annex A to submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (18 March 2016).

some of the inputs used in the model are different to those used by Z.[66] Nevertheless, we consider that Z's model conveys the approximate range of costs that would likely be borne by Z and BP if they were to increase throughput fees to each other post-merger.

93. This modelling shows that BP and Z would continue to be dependent on each other in different areas. Of note,
[
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94. Given any net balance of fuel borrowed and loaned between Z and BP is unlikely to be large and could be in either Z or BP's favour, it is not clear that there would be a system-wide benefit to Z if it was to increase BP's throughput fees and BP was to retaliate. There are also risks that Z perceives could arise from disrupting the borrow and loan system.[67] We consider that this uncertainty and risk would likely provide sufficient constraint on the merged entity from exploiting market power and raising throughput fees above cost in any terminal market.

Does Mobil have the ability to constrain Z from increasing throughput fees?

95. Historically, Z and Chevron borrowed more product from Mobil's terminals [ ]. This is largely to do with Mobil's position as the sole terminal owner at Woolston (including the Woolston pipeline) and Bluff. Following a landslide in March 2014 that severely damaged some of Mobil's terminals at Lyttelton,
[
] Chevron does not own any terminals at Lyttelton.[68]

96. On 21 October 2015, Mobil advised COLL (including a representative from Z) that it was seeking internal approval to rebuild its terminals at Lyttelton to replace those damaged in the landslide, although it did not provide a timeframe for this work to be completed.[69] Z is of the view that Mobil will rebuild these terminals and Z's internal documents support this statement.[70]

97. [ ],[71] we are satisfied that the threat of Mobil rebuilding its terminals at Lyttelton, and

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66 For example, the different alternative trucking costs that we sourced from industry participants.

67 These risks include temporary price gouging by other major fuel firms in relation to throughput fees or losing the support of other major fuel firms for key supply chain initiatives. Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (4 March 2016) at [8] and Commerce Commission interview with Z (19 February 2016).

68 Source: terminal throughput data sourced from industry participants.

69 Annex N of submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (18 March 2016).

70 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (23 October 2015) at footnotes 9-10 and Commerce Commission interview with Z (7 March 2016).

71 Commerce Commission interview with Mobil (11 February 2016).

[ ], would be sufficient to constrain the merged entity from exercising market power to increase throughput fees above cost to Mobil in any terminal market.

98. Even if Mobil did not rebuild its terminals at Lyttelton, it appears to us that any net balance could be in either Z or Mobil's favour.[72] Therefore, like with BP, Z would face uncertainty of what system-wide benefit (if any) it would achieve by increasing throughput fees to Mobil in any terminal market. Z's perceived risk of disrupting the borrow and loan system is likely to provide further constraint.

99. Given Mobil's current position and the threat to Z if Mobil were to rebuild its terminals at Lyttelton, we consider that Mobil's countervailing power would sufficiently constrain the merged entity from exploiting any market power by increasing Mobil's throughput fees above cost.

Ability of Z to exercise market power by [ ]

100. While we do not consider that the merged entity would be able to exercise market power by increasing throughput fees up to the next best alternatives of other fuel firms, we consider it likely that Z would increase Chevron's current throughput fees at all its terminals by changing the method by which those terminals are priced. Chevron says it only recovers operating costs [ ].[73]

101. Therefore, post-merger, we expect Z would increase the throughput fees at its newly acquired Chevron terminals [ ].

102. We considered whether such a price increase would be indicative of a substantial lessening of competition. In our view, the answer is no.

103. We acknowledge that [ ]. Specifically, [ ], Z charges BP and Mobil throughput fees of between [ ]cpl to [ ]cpl.[74] Whereas, Chevron's throughput fees to BP are between [ ]cpl to [ ]cpl and Chevron's throughput fees to Mobil are between [ ]cpl and [ ]cpl.[75]

104. Our expectation that Z would seek to recover [

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72 Of note, [ ].

73 Commerce Commission interview with Chevron (22 March 2016) and Commerce Commission interview with Z (17 March 2016). Chevron stated that it had already recovered [ ].

74 At December 2014. Data supplied by Chapman Tripp on behalf of Z (10 November 2015).

75 At September 2015 with the exception of diesel at Dunedin, where Chevron charges both BP and Mobil [ ]cpl. Data supplied by Buddle Findlay on behalf of Chevron (14 October 2015).

].[76]

105. We consider it likely that Z would increase Chevron's throughput fees [ ], despite the possibility that it might end up facing higher net costs across the borrow and loan system because of retaliation by BP and Mobil. When Z [ ].[77] [ ]

106. While Z may increase Chevron's throughput fees, we do not consider that this is indicative of a substantial lessening of competition. We note Z's change to Chevron's pricing methodology is not necessarily contingent on Z having market power, but rather reflects a change in ownership. [ ] Z would apply the change across all Chevron terminals regardless of whether it has regional market power or not.

107. We do not consider the consequences of the pricing changes would substantially impact BP and Mobil. BP and Mobil would both be able to offset the effects of any throughput fee increase by retaliating against Z, so that Z's [ ] would likely result in a relatively insignificant overall net cost increase or a net gain to BP and/or Mobil. This has the additional effect of not impacting BP and/or Mobil's ability to compete in related downstream markets.

108. Moreover, even if BP and/or Mobil faced some net cost increase as a result of Z increasing the Chevron terminal throughput fees, it would be unlikely to have a substantial effect on competition downstream. Based on 2014 draw down data, if Z [ ] Chevron's throughput fees in terminal markets where BP and/or Mobil have no other feasible alternatives, then BP would face increased costs of around [ ] per annum, and Mobil would face increased costs of around [ ]. We estimate that this would amount to a [ ]cpl increase in costs for BP and a [ ]cpl increase for Mobil.

The supply of fuel to retail customers through service stations

109. This section deals with the impact of the proposed merger on the retail supply of fuel through service stations.

110. As a result of the proposed merger, the competition between Z and Chevron for retail customers that purchase petrol and diesel at service stations would be lost. We consider that:

[76] Commerce Commission interview with Z (17 March 2016).

[77] Appendix B of submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (24 November 2015).

110.1. the proposed merger would have, or would be likely to have, the effect of substantially lessening competition due to an increase in unilateral market power in 22 local areas; however, Z has offered a divestment proposal that would remedy concerns in all of those areas; and

110.2. the proposed merger would not have, or would be likely to have, the effect of substantially lessening competition due to an increase in coordinated market power.

111. For the reasons explained in her dissenting opinion, Dr Walker agreed with our conclusion on unilateral market power, but disagreed with our conclusion on coordinated market power.

Background

112. Z and Chevron both compete to supply retail customers through service stations. BP, Mobil and Gull also compete to supply retail customers. The means through which each of the firms reach retail customers can, however, differ. For example, as we describe below, Z owns and operates most of its service stations whereas Chevron mainly wholesales fuel to independent retailers. We take into account the fuel firms' operations at both the wholesale and retail level in our analysis. We have taken this approach since the terms of the wholesale supply agreements enable the wholesaler to influence the retailer's price. This is because:

112.1. the contracts are long term
[
]; and

112.2. the cost of wholesale fuel influences the retailer's ability to set a competitive price.

113. Where relevant, we identify how the different types of arrangements affect the nature of competition.

114. The main types of arrangements are set out below.

114.1. Retail sites that are owned and/or operated by the major fuel firms and Gull.[78] This includes BP Connect sites, almost all Z sites, most Mobil and Gull sites, and a few Caltex sites.

114.2. Retail sites that are owned and operated independently from the major fuel firms and Gull.[79] The owner of each site sets the retail price. The types of sites that this includes are set out below.

114.2.1 Sites that carry the brand of the major fuel firms (Z, BP 2GO, Caltex, Mobil) or Gull but are owned and operated by individual owners.[80]

[78] We refer to these as "company" sites.
[79] We refer to these sites as "independent" sites.
[80] We refer to such service stations as "dealer" sites.

These sites have long term supply agreements ([ ] years) with a supplier. We understand these contracts often have clauses which [ ].[81]

114.2.2 Retail networks with their own brand but which purchase fuel from one of the major fuel firms on a wholesale basis. This includes:

114.2.2.1 GAS and Challenge, which operate networks of dealer sites. These networks have long term supply agreements for fuel from, respectively, BP and Farmlands (who sources from Chevron). The dealers set their own retail price;

114.2.2.2 reseller brands such as NPD, Waitomo or McKeown. These sites are a mix of those owned by the reseller and others that are dealer sites. The dealers set their own retail price. The resellers have long term supply agreements with one of the major fuel firms; and

114.2.2.3 single dealer sites like Fuelling Kapiti and unbranded sites. These sites negotiate a wholesale supply arrangement with a major fuel firm or reseller.

114.3. Retail sites operated by a Foodstuffs supermarket branded as either a Pak'nSave or New World. Mobil won a long-term contract from BP to supply these sites in 2012.
[ ]

115. Z's general strategy is to own and operate service stations under the Z brand.

115.1. Z owns a network of around 205 service stations located throughout New Zealand, at which it owns the assets and sets the retail price.

115.2. Z also supplies six dealer sites operating under the Z banner. The dealers own the assets and set the retail price.
[
]82

115.3. Z also supplies fuel at the retail level indirectly through Southfuels, which Z supplies on a wholesale basis. Southfuels mainly supplies bulk customers but there are also around 8 service stations under the Southfuels and Northfuels brands.

81 See for example, submission from BP to the Commerce Commission (11 September 2015).
82 Clearance Application from Z (30 June 2015) at [234].

116. Z's national retail price is known as the main port price (MPP). Z has advised that it would prefer to have all of its sites at MPP to ensure a consistency of offer and for administrative ease.[83] Z has advised that, up until the past couple of years it was normal to have [ ]% of the sites at MPP, but there is now around [ ]% due to increased competition on board prices.[84] The precise number of sites at MPP changes regularly as Z adjusts its strategy for each site. MPP continues to apply in a number of areas including Wellington, Christchurch and Timaru.[85] Z refers to the areas where MPP does not apply as the "exception areas", which mainly include areas in the upper North Island.[86] Around [ ]% of sites are above MPP.[87]

117. Chevron's strategy is different to Z's. Chevron operates as a wholesaler to a network of dealer sites. Chevron previously owned service stations in New Zealand but started to sell those in 2006 following a global Chevron decision to move out of service station ownership.

    117.1. There are around 156 Caltex-branded stores. Chevron owns 10 of these stores with the remainder being owned by dealers. The contracts with dealers are long term (up to 15 years), with options for renewal and give Chevron the right of first refusal if the outlet is going to be sold. The agreements include a licence to use the Caltex brand, which Chevron owns. In most cases the dealer owns the assets although the exact mix of asset ownership can differ between service stations. Chevron sets a daily wholesale price based on a discount (currently [ ]cpl) from a notional national retail price that Chevron sets. The dealer sets the retail price. Chevron may offer "price support" (a discount on the wholesale price) to those stations that face retail prices that are below Chevron's notional national retail price (such as those areas with relatively strong competition).

    117.2. Chevron funds the AA Smartfuel programme, which customers can use to get discounts off board prices. The dealer may also negotiate other rebates and commercial arrangements with Chevron.[88]

    117.3. Chevron also supplies fuel at the retail level indirectly through the Challenge and McKeown brands. Chevron wholesales fuel to Farmlands. Farmlands has separately negotiated a contract to supply the Challenge independent network. Chevron owns the Challenge brand and licenses this to Farmlands, which then sub-licenses the brand to the dealer sites in the network. Chevron wholesales fuel to the reseller McKeown which supplies around 18 retail sites in rural areas.

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83 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (12 March 2016) at [79].

84 Commerce Commission interview with Z (26 November 2015).

85 Price data provided by Z.

86 See for example, Z refers to [ ] in Z internal e-mail [ ] (document ID: ZEN.100.03594) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016). [ ]

87 Price data provided by Z.

88 Commerce Commission interview with Chevron (2 November 2015 and e-mail from Buddle Findlay (on behalf of Chevron) to the Commerce Commission (10 July 2015).

118. BP's and Mobil's retail distribution model sits between Z's primarily company-owned model and Chevron's dealer-owned model.

118.1. BP owns around 102 service stations which mostly operate under the "BP Connect" banner. It owns the assets and generally sets the retail price at these service stations. These tend to be on major highways and in major metro areas.[89]

118.2. BP supplies around 95 dealer sites mostly operating under the "BP 2GO" banner. These tend to be in regional provincial areas or in areas complementary to the BP Connect stations in metro areas.[90]
[

]91

118.3. BP is the current wholesaler to GAS. GAS is a network of around 123 sites.
[ ]92

118.4. BP also supplies fuel at the retail level indirectly through its resellers. BP wholesale fuels to RD and Rural Fuel who supply a few sites in rural areas.

119. Mobil operates in a similar way.

119.1. Mobil owns around 121 service stations under the Mobil banner. It owns the assets and generally sets prices at these service stations.

119.2. Mobil supplies around 46 dealer sites operating under the Mobil banner. Mobil has advised that
[ ].93

119.3. Mobil currently holds the contract to supply the approximately 49 Foodstuffs branded service stations.
[ ]94

119.4. Mobil also supplies fuel at the retail level indirectly through its resellers. Mobil wholesale fuels to resellers Allied, NPD and Waitomo who each supply a network of sites, mainly in rural areas.

89 Commerce Commission interview with BP (9 November 2015).
90 Ibid.
91 Ibid.
92 Ibid.
93 Service stations workbook attached to an e-mail from Mobil to the Commerce Commission (16 July 2015).
94 Ibid.

120. Gull supplies fuel at the retail level solely through service stations operating under the Gull banner.

120.1. Gull directly operates around 49 service stations using the Gull banner. It sets the retail price at those sites.

120.2. Gull has wholesale supply agreements with around 14 dealer sites operating under the Gull banner. The dealer owns the assets and sets the retail price.[95]

121. The approximate regional share of the major fuel firms based on the number of retail service stations they supply is set out in Table 3.[96]

Table 3: Regional share of major fuel firms based on station count as at 1 July 2015

Region	Total stations	Percent of stations supplied					
		Z	Chevron	Merged entity	BP	Mobil	Gull
Northland	72	10%	18%	28%	50%	19%	1%
Auckland	300	22%	15%	37%	29%	25%	9%
Waikato	166	16%	14%	30%	25%	25%	8%
Bay of Plenty	84	18%	17%	35%	18%	17%	19%
Gisborne	19	11%	16%	26%	26%	32%	5%
Taranaki	32	19%	19%	38%	41%	19%	0%
Hawkes Bay	46	17%	13%	30%	26%	30%	7%
Manawatu	67	12%	22%	34%	28%	28%	6%
Wellington	98	21%	18%	40%	26%	32%	1%
Nelson	22	27%	14%	41%	9%	50%	0%
Tasman	12	17%	25%	42%	8%	50%	0%
Marlborough	20	20%	20%	40%	15%	45%	0%
Canterbury	160	20%	31%	51%	22%	26%	0%
West Coast	24	4%	25%	29%	25%	42%	0%
Otago	91	13%	30%	43%	30%	23%	0%
Southland	52	6%	35%	40%	21%	31%	0%
Total	**1265**	17%	20%	37%	27%	26%	5%

Source: Industry participants

122. The approximate national share of each retail banner based on the number of retail service stations is set out in Table 4.[97]

[95] Gull document attached to an e-mail from Gull to the Commerce Commission (3 July 2015).

[96] The service stations for each fuel firm include those they operate themselves and supply fuel to on a wholesale basis. Note that not all rows add to 100% because we were unable to identify the wholesale supplier of some service stations and numbers are approximate only because stations open and close regularly.

[97] "Others" include unbranded service stations, such as auto repair shops in rural areas that have a petrol pump.

Table 4: National shares of retail banners based on station count as at 1 July 2015

Supplier	Banner	Total stations	Percent of stations
Z	Z (company-owned)	205	16%
Z	Z (dealer-owned)	6	0%
Z	Southfuels	8	1%
Chevron	Caltex (company-owned)	10	1%
Chevron	Caltex (dealer-owned)	146	12%
Chevron	Challenge	81	6%
Chevron	McKeown	18	1%
BP	BP (company-owned)	102	8%
BP	BP (dealer-owned)	95	8%
BP	GAS	123	10%
BP	RDP	14	1%
BP	Rural Fuel	1	0%
BP	Spirit	2	0%
Gull	Gull (company-owned)	49	4%
Gull	Gull (dealer-owned)	14	1%
Mobil	Mobil (company-owned)	121	10%
Mobil	Mobil (dealer-owned)	46	4%
Mobil	Allied	71	6%
Mobil	New World	12	1%
Mobil	Pak'nSave	37	3%
Mobil	NPD	25	2%
Mobil	Waitomo	22	2%
Various	Others	57	5%
Total		**1265**	**100%**

Source: Industry participants

123. The major fuel firms and Gull together directly set the retail price for around [ ]% of service stations in New Zealand, with the remainder set by independent owners.[98] Where they do not directly set the price, the major fuel firms and Gull set the wholesale price so influence the retail price at independent service stations to that extent. Depending on the form of the retail contracts, those independents may have limited control over retail prices. For example, Chevron sets the wholesale price to Caltex dealers on the basis of a margin of [ ]cpl from the prevailing retail price. There are few examples of Caltex service stations acting aggressively, which suggests they have limited pricing flexibility.[99] However,

[98] Note that the owner of the site will normally set the retail price but that is not always the case. For example, the fuel firm might own the site but have a dealer operating the site and setting the retail price; or a third-party may own the site but the fuel firm owns the fuel in the storage tank and sets the retail price.

[99] Commerce Commission interview with Chevron (2 November 2015).

[ ] there are examples of Mobil dealers acting aggressively.[100]

124. The major fuel firms advised that they have regard to local competition when setting the wholesale price on the basis that they will lose volumes if they price too high relative to their rivals. Retailers often use "price markers" to monitor local competition. [ ][101]

How the proposed merger could substantially lessen competition

125. We considered two ways in which the proposed merger might lead to higher prices: through an increase in unilateral market power; or through an increase in the potential for coordinated market power.

125.1. Unilateral market power arises when a firm merges with another that would otherwise provide a significant competitive constraint.[102] The merged entity would no longer need to worry about losing customers to its close rival, which would create the incentive to raise prices. This is referred to as "unilateral" effects, because the merged entity can raise prices acting alone.

125.2. Coordinated market power arises when a merger increases the potential for the remaining competitors to coordinate their behaviour leading to higher prices.[103] This may occur when the firms in the market can reach an implicit agreement to accommodate each other's price increases, even though they are in a position to undercut them. This is referred to as "coordinated" effects because it concerns the collective behaviour of the firms involved.

126. We sought to identify where the proposed merger may have unilateral market effects in retail markets. While Z and Chevron operate different business models in the retail market (as discussed above), we consider the two firms do impose a constraint on one another. Z sets its retail price taking into account rivals, including Caltex, Challenge and McKeown service stations.[104] If Z set its retail prices too high, then Caltex independent retailers would be able to undercut Z and attract customers. Chevron sets wholesale price taking into account the retail price.[105] The

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100 See for example, Z internal document [ ] (document ID: ZEN.100.02992) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016). [ ]

101 For example, Clearance Application from Z (30 June 2015) at [238] and [ ].

102 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at 32.

103 Ibid at 35.

104 See Clearance Application from Z (30 June 2015) at [113-114]; Z refers to Challenge's prices in some internal e-mails, for example, Z internal e-mail [ ] (document ID: ZEN.100.00388) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2016); and [ ], see for example, Z internal e-mail [ ] (document ID: ZEN.100.02265) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (9 February 2016).

105 Commerce Commission interview with Chevron (2 November 2015).

wholesale price influences the retailer's ability to set a competitive retail price. If Caltex set its wholesale price too high, the independent retailers that it supplies would not be able to compete effectively against rivals. Therefore, Z and Chevron impose a constraint on one another and that constraint would be lost from the proposed merger.

127. We also considered whether the proposed merger creates the potential for coordinated effects. The retail fuel markets exhibit some characteristics and features that raised concerns over the potential for coordination. This includes: increased retail margins, use of national prices, cross-area uniformity of prices, displayed pump prices, homogeneity of fuel, similarity of costs and high entry barriers. By removing a fuel firm from the market, the proposed merger could make coordination more likely or, if coordination already exists, more complete or sustainable.

Market definition

128. For the product market, Z submitted that all types of fuel (diesel, premium petrol, and regular petrol) should be included in the same market on the basis that the manner of distribution is the same.[106] We agree with that approach. Almost all service stations offer all three types of fuel so there would be no material difference in the analysis by treating them separately.[107]

129. While fuels are largely homogeneous, the quality of services provided at each site varies. These range from those with forecourt attendants, coffee made by a barista, and toilets to those that are unmanned with no other facilities. Higher quality stations tend to charge higher prices for their fuel as some consumers are willing to pay more for those services.[108]

130. A primary reason for a customer's choice of a service station is location.[109] This means that the markets that service stations fall within are localised but geographically differentiated. The fuel firms advised that they monitor and may follow the price changes of their closest rivals in an area [ ].[110]

106 Clearance Application from Z (30 June 2015) at [223].

107 The AA in its submission noted that there are some differences in the premium petrol products that retailers offer. Submission from AA to the Commerce Commission (9 September 2015).However, we were satisfied that we did not need to analyse the different fuel products separately.

108 For example [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (6 November 2015) at 12.

109 [ ] Clearance Application from Z (30 June 2015) at [292].

110 For example, [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (16 November 2015).

131. Z submitted that the starting point for the relevant geographic market should be a radius of 5km because consumers are mobile and it would be consistent with previous cases.[111]

132. The evidence we have viewed supports a narrower starting point. We recognise that customer driving patterns are complex and will differ in each location. Despite this, the evidence we have viewed suggests that in general the greatest competitive threat is from nearby service stations. For example:

132.1. [ ];[112] and

132.2. Z internal documents reviewing station performance focus on competitors close by, less than [ ] away.[113]

133. The appropriate geographic market differs for each location. On a conservative basis, we have used a 2km radius as a starting point to identify problem areas.[114] We accept that there is likely to be constraint from service stations further away. We have taken account of those constraints on a case-by-case basis.

Competition assessment – unilateral effects

134. As already described, the strongest constraint on a service station's prices is that customers would switch to nearby rivals. Where the proposed merger combines nearby rivals, we assessed whether Z could profitably raise the retail price at the Z site and/or increase the wholesale price to the Chevron site (or reduce any price support).[115]

135. Z submitted that it would not be able to sustain higher prices at any site post-merger. This is because: prices are the same across a number of sites; prices are transparent; consumers are mobile; Z cannot identify price insensitive customers; and it would not be able to predict which service stations customers would switch to.[116] However, for the following reasons we consider that Z may be able to

111 Clearance Application from Z (30 June 2015) at [224-225].

112 Clearance Application from Z (30 June 2015) at [238] and Commerce Commission interview with Z (26 November 2015).

113 For example: [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (2 September 2015) at 4 and [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 September 2015).

114 Choosing a narrower market is normally more conservative because it implies fewer competitors. However, a narrower market also raises the risk of missing overlaps between the merging firms. As we explain further below we have avoided this risk by assessing competition: when Z or Chevron are within 2km of each other; when they do not fall within 2km of each other but are still each other's closest competitor; or if they price mark one another.

115 As noted above, price support is a discount that Chevron gives on its national wholesale price for its retailers that face retail prices that are below the national retail price.

116 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (23 October 2015) at 24-27.

profitably increase the retail price at Z sites and/or increase the wholesale price to Chevron sites (or reduce any price support).

135.1. Z does not have to be able to identify those customers that would switch to Chevron. So long as at least some customers would switch to a Chevron-supplied outlet and vice versa in response to a price increase, then the proposed merger would increase the incentive for Z to raise prices (since Z would recapture some customers that would otherwise have been lost to a Chevron-supplied outlet).

135.2. Z could test whether a price increase is profitable through a temporary price rise. Internal documents show that [ ].[117]

135.3. Similarity of prices does not necessarily show customers view sites as being substitutable. There are many sites at MPP around the country. They are unlikely to all be in the same market which shows the similarity of prices could be caused by something other than customer substitution. There are also examples of sites that are located quite near to each other but at vastly different prices.[118] This shows price differences already occur within small local bands, and there is little to suggest that this could not happen at other sites.

136. Z also submitted that Chevron is a price follower[119] and therefore the proposed merger would not affect price competition.[120] Z submitted an economic report from Professor Jerry Hausman that showed the presence of Chevron did not have an effect on Z's prices.[121] We commissioned RBB Economics to review that report. Over and above RBB Economics' critique, we are not satisfied that Professor Hausman's results are sufficient to show Chevron is not a competitive constraint in all situations. While we accept Chevron is generally a passive competitor, the evidence suggests there are circumstances in which it may impose a constraint. This evidence includes:

136.1. Chevron has stated that, although it is a price follower, it does not follow "blindly";[122]

136.2. Z price marks some Caltex stations, suggesting that they are competitively significant;[123] and

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117 See for example [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (6 November 2015).

118 [ ]

119 Clearance Application from Z (30 June 2015) at [273].

120 Ibid at [227].

121 Ibid at [274].

122 Commerce Commission meeting with Chevron (2 November 2015).

123 Appendix N to Clearance Application from Z (30 June 2015).

136.3. internal Z documents and internal e-mails include comments that suggest Chevron is a competitive constraint in certain local areas and can be slow to follow prices up.[124]

137. Z and Chevron between them supply (directly or indirectly through a reseller) over 400 service stations. We used a filter to identify those areas of concern (ie, those areas where local Z and Chevron supplied stations were likely to impose a competitive constraint on each other pre-merger). A Z or Chevron service station was caught by the filter if:

137.1. there would be a reduction of brands from three to two or two to one within 2km as a result of the proposed merger;

137.2. Z price marks a Chevron station (regardless of where it was within 2km) or vice versa (which may suggest the service stations view each other as particularly close competitors);

137.3. there would be no change in the number of competitors in an area post-merger but a Chevron service station was the closest competitor (for example, if Z and Chevron are, respectively, the only service stations in two nearby rural towns); or

137.4. Z and Chevron are the closest rivals on a motorway, and other rivals are located off the motorway (suggesting those rivals are not close competitors even if they are located nearby).

138. We included those service stations that Z and Chevron supply through distributors, including Challenge and McKeown. For the purposes of the filter, we also treated all service stations directly or indirectly supplied by BP and Mobil, respectively, as a single brand. We recognise that this approach simplifies the nature of competition. For example, it treats dealers as if they were part of the wholesale supplier, even though dealers set their own price. However, given there are potentially hundreds of areas of overlap and the nature of the wholesale agreement enables the wholesaler to influence the retailer's ability to compete, we consider this is a pragmatic approach.

139. The initial filter identified 88 areas. We added a further six areas based on areas identified as being of concern in submissions from interested parties. We then manually reviewed all 94 areas using maps and other basic information. This reflected that stage one did not take into account the location of service stations relative to each other. We excluded those areas where the location of the Z and Chevron sites suggested they were unlikely to be close competitors.

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[124] See for example: [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015) at 3, 6-7, 17; [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015) at 1; Z internal e-mail [ ] (document ID: ZEN.102.02071) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016); [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015) at 2.

140. That process left 31 areas. We then conducted a detailed local analysis of those areas taking into account site specific information that we gathered from market participants and our own research (such as site visits, newspaper articles and other information we could gather about the site).

141. When analysing the 31 areas, we assessed whether entry and expansion in response to a price increase would be likely, sufficient in extent and timely to prevent a substantial lessening of competition (the LET test).[125]

141.1. We assessed whether entry was likely by considering the entry plans of rivals. Market participants provided entry and expansion plans for the next one to two years. We only took into account the impact of new entry on competition in a local area where there was evidence of planned entry. We were not satisfied that we could rely on the potential for unplanned new entry to constrain increases in prices. This is because an investment in a service station is a several decade commitment. As such, we were told that opening a new site would be based on [ ].[126] Moreover, interviews with industry participants suggested that the process for locating a suitable site, obtaining the necessary consents and developing the site can take several years.[127]

141.2. Where we were aware that a rival was planning entry we considered whether it would be sufficient to prevent a substantial lessening of competition. We considered: the location and nature of the retailer's offer (for example, full service or unmanned); whether the entrant had a past history of competing aggressively; and whether the entrant had a different upstream supplier to the existing competitors.

142. The more detailed analysis led to a further nine areas being removed from our list of 31 areas. These areas were removed on the basis that clear competitive constraints would remain post-merger. This was for reasons such as: the Z or Chevron station price-marked a different brand; internal documents identified another site as being the main driver of prices; entry satisfied the LET test as described above; or because traffic flows suggested other sites were closer competitors. This left us with 22 remaining areas. These areas fell into three categories.

142.1. Where there would be a reduction of competitors from two to one in an isolated area. This applied to:

142.1.1 Darfield/Kirwee;

142.1.2 Kaiapoi/Waimakariri;

142.1.3 Kaikohe;

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125 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at 37-40.

126 Commerce Commission interview with Z (15 September 2015).

127 For example, Commerce Commission interview with Z (15 September 2015) and [ ].

142.1.4 Opotiki;

142.1.5 Paihia; and

142.1.6 Te Aroha.

142.2. Where there would be a reduction in the number of competitors from three to two and the remaining constraints would be insufficient to prevent a substantial lessening of competition. This applied to:

142.2.1 Addington;

142.2.2 Hutt Road;

142.2.3 Kaitaia;

142.2.4 Matamata;

142.2.5 Milton;

142.2.6 Motueka/Riwaka

142.2.7 Picton

142.2.8 Putaruru;

142.2.9 Rangiora;

142.2.10 Riccarton; and

142.2.11 Twizel.

142.3. Where the merging parties are likely to be particularly close competitors due to traffic flows and the nature of customers. This applied to:

142.3.1 Epsom; and

142.3.2 Yaldhurst.

143. However, as discussed further in the divestment section, Z offered a divestment that remedied those concerns. Because some of the 22 areas above overlap, Z was able to remedy those concerns through an undertaking to divest 19 service stations.

Competition assessment – coordinated effects

How we assess whether a merger is likely to result in coordinated effects

144. A merger can substantially lessen competition if it increases the potential for the merged entity – here Z and Chevron – and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power to reduce output or increase prices across a market. For example, firms may accommodate

each other's price increases if they consider that it is more profitable for them than competing.[128] We refer to these effects as 'coordinated effects'.

145. Coordinated effects differ from unilateral effects (which we considered in the previous section). Unilateral effects focus on whether the merged entity would be able to sustainably increase prices on its own (ie, without having to concern itself with what its competitors might be doing). Coordinated effects require the merged entity and its competitors to act in a coordinated way to increase prices in a market.[129]

146. It follows that successful coordination requires firms to share some kind of common knowledge as to how they will interact with one another to collectively increase prices. This shared knowledge may well fall short of a contract, arrangement or understanding which otherwise breaches Part 2 of the Commerce Act 1986. We refer to the common knowledge among firms as an 'implicit agreement' in our Mergers and Acquisitions Guidelines and in our discussion below.

147. Successful coordination also requires the parties to that coordination to monitor and detect whether other firms are complying with expected outcomes, and to deter deviation through "punishment".[130] This is to ensure that the parties do not have an incentive to depart from the coordinated outcome to improve their own position at the expense of the remaining parties.

148. The question raised by this merger is whether, in any local retail fuel market, a coordinated outcome is more likely to emerge (or be sustained) if Z acquires Chevron than if Z did not acquire Chevron.

149. We have reached a different answer to this question to that reached by Dr Walker. She has set out her reasons in her dissenting opinion, which we have read in draft. The reasons which follow represent our views.

Summary of the majority's views

150. We are satisfied that Z's acquisition of Chevron would not have the effect or likely effect of substantially lessening competition in any local retail fuel market via coordinated effects. That is, the merger would not make coordinated effects any more likely to emerge, or make any existing coordinated effects more sustainable or complete.

151. We acknowledge that a substantial lessening of competition via coordinated effects is possible, but this possibility falls short of the 'real chance' required to demonstrate that a substantial lessening is likely.

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128 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at [3.84].
129 Ibid at [3.85].
130 Ibid at [3.88].

152. In reaching this conclusion we have applied the two stage process set out in our Merger and Acquisitions Guidelines.[131]

152.1. We first ask whether the local retail fuel markets have characteristics which make them vulnerable to coordination. This includes undertaking an assessment of whether there is any evidence that coordination is already occurring in any markets or has occurred in the past.

152.2. We then ask whether Z's acquisition of Chevron changes conditions in local markets so that coordination is more likely, more complete, or more sustainable.

153. Using this framework we have reached the following views.

Do local retail fuel markets have characteristics that make them vulnerable to coordination?

154. There are a range of characteristics that are commonly accepted as making a market vulnerable to coordination. However, the existence of these features on their own point only to a market being vulnerable to coordination. They do not indicate whether coordination is occurring, will occur in the future, or whether the merger makes any difference to the likelihood of coordination.

155. We consider that many local markets are not likely to be vulnerable to coordination. These are the local markets where Gull is present. We view Gull as a strong competitive force that will make achieving any coordinated outcome very difficult.

156. For all other local markets, some characteristics point towards the markets being vulnerable to coordination, while others suggest coordination may be difficult. It is unclear how these factors balance out and we cannot draw any firm conclusion whether these markets are vulnerable to coordination on this basis alone.

157. We looked at the evidence of current market behaviour by Z and Chevron and their competitors to help us determine whether the markets are vulnerable to coordination. We find that much of the evidence could be viewed in different ways, one consistent with coordination and one consistent with competition. But when viewed in the round we consider that even on the view that is most adverse to Z, that evidence points only to the possibility of coordination occurring in these local markets in the form of an implicit agreement between competitors to accommodate each other's price increases. The evidence is not strong or unambiguous and the evidence we have reviewed could also be consistent with competitive outcomes.

158. Having examined the market characteristics and the evidence of market behaviour we conclude that it is possible that these markets are vulnerable to coordination, but we cannot say that this is likely or that coordination is occurring.

[131] Ibid at [3.86].

Would Z's acquisition of Chevron change conditions in these local markets so that coordination is more likely, more complete, or more sustainable?

159. In markets where there is no aggregation between Z and Chevron, the prospects for coordinated outcomes would not change.

160. In markets where Gull is present, Gull's continued presence will continue to make achieving a coordinated outcome difficult. The removal of Chevron would not affect the constraint Gull provides.

161. In the 22 most concentrated of the local markets where aggregation would occur, the divestments that Z has offered remove the risk that the proposed merger would affect the prospects of coordination because the number of competitors in the market will be the same both with or without the merger.

162. In all other markets, the evidence suggests that Chevron is not a party that is preventing or limiting coordinated outcomes. Chevron has been a passive competitor. Therefore, we do not consider that the removal of Chevron from the market would make a material difference to outcomes in these local markets.

163. We accept the possibility that absent acquisition by Z, Chevron may be acquired by a third party that would take a materially more aggressive competitive approach than Chevron has to date. While that is a possibility, there is no evidence before us to suggest that it is likely that a new owner would operate the business differently. And, in any event, given our view that it is only possible that these markets are vulnerable to coordination, we do not consider that the combination of two possibilities (that the market is vulnerable to coordination and that a new owner of Chevron would act more aggressively) means that Z's acquisition of Chevron creates a real chance of a substantial lessening of competition via coordinated effects.

164. Dr Walker's view differs from our own. She is not satisfied that the proposed merger will not have, or would not be likely to have, the effect of substantially lessening competition due to coordinated effects in local retail markets. Where we differ is that Dr Walker has concluded that the market behaviour evidence suggests that retailers are already coordinating albeit that the coordination is more successful and complete in areas priced closer to MPP (primarily the Wellington region and the South Island). Dr Walker also concludes that she cannot exclude the real chance that removing Chevron would materially affect the prospects of coordination. We address both of those points in our discussion below.

Do local retail fuel markets have characteristics which make them vulnerable to coordination?

165. A range of market features are commonly accepted as making a market more vulnerable to a coordinated outcome. That is, these are market features that make it more likely that firms will be able to successfully coordinate their behaviour to increase their profits. We list seven factors in our Merger and Acquisitions Guidelines. Not all need be present for a market to be vulnerable to coordination.[132]

[132] Ibid at [3.89].

Nor does the existence of some or all of these features inevitably mean that firms will engage in coordinated behaviour.

166. Indeed, it is often the case that a market will exhibit a mix of characteristics, and there is no bright line at which a market moves from not being vulnerable to coordination to being vulnerable to coordination. Rather, the market characteristics must be viewed in the round and a judgement made about whether and to what extent a market will be vulnerable to coordination.

167. We consider below the extent to which these market features are present in local retail fuel markets.

Products being sold are homogeneous

168. It is easier for firms to engage in coordination if they sell homogeneous products. This is because it is easier for the firms to reach an agreement on what the coordinated outcome should be. The more differentiated the firms' products, the more complicated it will be to reach an accommodation that suits all parties and which they will not cheat on.

169. Retail fuels themselves are, more or less, homogeneous. There are some differences however. For example, where fuel firms have chosen to mix additives into the fuel prior to supplying it to service stations, and in the differences in the premium fuels that some sites offer (eg, some BP and Mobil sites offer 98 rather 95, and Gull uses a 98 with an ethanol mix). Nevertheless, we consider that retail fuels are best thought of in this context as homogeneous.

170. The same cannot be said for the fuel firms' service offerings, which are differentiated, even within brands. For example, service stations range between unmanned self-service stations at one end of the service spectrum to full service sites with a café and a forecourt concierge at the other. Indeed, Z has embarked on a deliberate strategy to differentiate itself and create a premium offer with services such as a concierge, "hotel standard" toilets and pay-at-pump,[133] while Mobil [ ].[134] At the other end of the service spectrum, Gull competes aggressively on price, [ ].[135]

171. This level of service differentiation would tend to make it more difficult for firms to coordinate, notwithstanding that the underlying fuel products are relatively homogeneous. Z's pricing strategy documents indicate that Z has sought to value the differences in competitive offerings by setting its prices relative to other service offerings. The differences are between [ ]cpl and in some cases expressed as a

133 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to Commerce Commission (11 December 2015) at 34.

134 Commerce Commission interview with Mobil (9 November 2015).

135 [ ], attached to e-mail from Gull to the Commerce commission (3 July 2015) at 9.

range.[136] By itself this does not indicate coordination, as it simply reflects Z's views on how it should set its prices and says nothing about whether it expects those differences to be reflected in the pricing of other retailers or adhered to in any particular market.

172. In our view, where there is a high level of service differentiation in a local market coordination is less likely because any implicit agreement would need to be nuanced enough to reflect the differences in service. In contrast, where there is low service differentiation in a local market, coordination would be relatively easier.

Firms can readily observe each other's prices or volumes

173. Successful coordination requires a high level of price or volume transparency so firms can check whether their competitors are complying with the expected coordinated outcome.

174. National volumes are likely to be transparent given the borrow and loan scheme the major fuel firms participate in. Firms are also likely to be able to obtain regional figures through the volumes submitted for the purposes of the Local Authority Petroleum Tax. However, importantly, the volumes of rivals on a local level are likely to be difficult to observe.

175. In terms of prices, at one level, fuel prices are highly transparent. Posted board prices mean rivals can easily view the prices set by their competitors. Furthermore, Z posts its MPP on its website. This is the price that Z would like to achieve, although in reality prices are lower than MPP at around [ ] Z's stores around the country.[137] Fuel companies also, at times, appear to have publicly announced network wide price changes in advance of those price changes taking place.[138]

176. The transparency of these headline or gross prices can be contrasted with the price consumers actually pay for petrol, and which the service stations receive. The actual price paid reflects any "off-board" discounts or other promotions available to a consumer. The off-board discounts and promotions that the rivals offer are normally on a national basis but sometimes are more targeted.[139]

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136 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to Commerce Commission (6 November 2015) at 12.

137 Commerce Commission interview with Z (26 November 2015).

138 For example, in an internal e-mail, Z proposed [ ]. See Z internal e-mail [ ] (document ID: ZEN.100.001842) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2016). [ ]

139 For example, Z made a 10cpl discount offer in Invercargill [ ]. Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (5 April 2016) at 3.

177. These discounts are less transparent than gross prices and account for a significant portion of sales. For example, Z estimates that off-board discounts apply to around [ ]% of its retail transactions.[140] These off-board discounts can include:

177.1. loyalty offers such as Flybuys or AA Smartfuels;

177.2. grocery fuel dockets;

177.3. targeted discount offers using customer databases; and

177.4. sales on commercial fuel cards, which include individually negotiated customer specific discounts, and which account for [ ]% of the major fuel firms' retail volumes depending on the region. Coordination on these volumes would be difficult undermining the potential for coordination more broadly.[141]

178. The firms also use non-price promotions to win market share. For example, Blockhedz was a successful promotion for Z, increasing its sales by [ ]%.[142] These types of promotions may be hard for rivals to value (and so to respond to with a discount) and may be difficult to replicate.

179. Some of these off-board discounts and promotions are easier to observe than others, but the reality is that they are being used as a competitive tool by firms to win market share. Investment in these types of discounting strategies and other promotions is creating a market place where pricing is more fragmented and complicated and so less likely to be conducive to coordination. That the fuel firms are introducing these offers (and making the market less transparent) is inconsistent with a shared goal to coordinate.

180. We also do not ignore the fact that there are a range of independent participants in retail markets. We return to this topic below. The plethora of independent price setters at the retail level would make coordination more difficult.[143] In conclusion, while headline retail prices are readily observable, as are publicly announced price changes (at least for the major fuel firms), there is a significant degree of off-board discounting activity. This discounting activity dilutes pricing transparency and means that achieving a sustainable coordinated outcome would be more difficult.

Firms of similar size and cost structure

181. It is easier to reach an implicit agreement to coordinate if the firms involved are of a similar size and face similar costs. This is because all the firms will have similar

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140 Clearance Application from Z (30 June 2015) at [283].

141 Source: industry participants' data.

142 Z internal e-mail [ ] (document ID: ZEN.100.02992) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016).

143 All of these independent retailers (except Gull (with limited exceptions)) are supplied by the major fuel firms at the wholesale level. However, the wholesale agreements are individually negotiated between the major fuel firm and the retailer. This makes it more difficult for the major fuel firms to coordinate (compared to if they directly controlled retail prices) because they cannot observe the wholesale prices, only the retail price the independent charges.

incentives and will benefit in a similar way from the coordinated outcome. The more asymmetric the market, the more complicated it is to reach an agreement and to sustain the coordination that flows from that.

182. At an aggregated national level, the major fuel firms each supply around a quarter of the market although some of this volume is supplied into local retail markets via independent retailers. However, the aggregate national picture overlooks the fact that retail fuel competition takes place at a local level. At a local and regional level volume shares are more asymmetric.

183. There is some degree of similarity of wholesale costs faced by the major firms and independent retailers.

183.1. The major fuel firms share many wholesale costs through their joint ventures in primary distribution, and face similar global movements in the price of crude and refined fuels. This creates some similarity in wholesale costs between them, although some differences remain.[144]

183.2. The similarity in wholesale costs of the major fuel firms will also influence the wholesale prices at which independent retailers – including Caltex and Challenge retailers – acquire fuel, although the commercial terms on which retailers acquire that fuel and therefore the actual wholesale cost to a retailer will differ.

184. However, there are also likely to be differences in the retail costs faced by any particular retailer. These will be driven by costs associated with the service offering employed by a retailer.

185. Furthermore, Gull is present in many local markets and has a different business model and a significantly different operating cost base.[145] It is seen as a challenger brand, and aggressive on price which sees prices being significantly lower in markets where Gull is present.[146] While we return to this topic later below, what the evidence suggests is that the presence of Gull in a market makes achieving a coordinated outcome very difficult.

186. Furthermore, the plethora of independent retailers across a range of local markets in New Zealand means that to achieve a coordinated outcome would require the

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144 For example, the actual costs to each firm of its crude and refined fuel depend on (among other things): the timing of those purchases; strategies for exchange rate hedging; and other differences in contracts. NERA (on behalf of Z) argued that [ ]. NERA Economic Consulting "Z Energy/Chevron – coordinated effects" (23 October 2015). It is not clear that price leadership is driven by such asymmetries. For example, it is not clear from the evidence that Z is more exposed to oil volatility than BP, Mobil or Chevron. BP and Mobil purchase fuel from whomever they obtain the best price, [ ]. Prior to 2010, Shell and BP led almost all the price changes whereas Chevron and Mobil led very few, despite the firms being similarly placed in respect of overseas operations.

145 Commerce Commission interview with Gull (4 September 2015).

146 For example, the AA has identified that prices are lower when Gull is present and has coined this the "Gull effect". Submission from AA to the Commerce Commission (9 September 2015) at 7.

relevant independent competitors in a local market to participate. Independent retailers are likely to have different costs and may well have different ideas about what an acceptable return is to those of the major fuel firms. The presence of one or more independents in a local market would also complicate the ability to achieve a coordinated outcome.

187. In conclusion, local markets include not only the large national firms, but local independents and in many cases Gull. These participants are all likely to have different costs. The presence of Gull, in our view, would make achieving a coordinated outcome very difficult given its different model and cost structure. The presence of independents, while not as significant as the presence of Gull, would also complicate the ability of firms to reach a coordinated outcome because coordination in each local market would require the implicit agreement to coordinate by local market participants.

Firms repeatedly interacting

188. Coordination is more likely in markets where consumers make smaller, regular purchases of a product, so that competitors can more easily learn what each other's responses to a price change are likely to be, and can test the appetite for a price increase while risking a smaller volume of sales should the price change not hold through a coordinated response by competitors.

189. New Zealand retail fuel markets are characterised by regular interactions. We therefore consider that this is a feature of the market that would be conducive to a coordinated outcome emerging.

Little innovation, stable demand and lack of supply shocks

190. Innovation and asymmetric demand or supply shocks have the potential to destabilise coordination. This is because it makes it hard for market participants to know whether a change in volumes is due to a rival cheating or due to an outside change in demand or supply.

191. The evidence suggests that retail fuel markets are continuing to evolve. As already discussed, Z has changed its offer and various firms have developed new off-board discounting methods, such as BP and Caltex joining AA Smart Fuel. Indeed, Z has lost significant market share as a result of the launch of AA Smart Fuel.[147] Therefore, while there is little innovation in terms of 'product', there is innovation in service offering and pricing behaviour.

192. This evolution is reflected in market share changes. While overall demand is growing only marginally, the demand of each firm is not stable. As shown in Table 5 below Mobil-supplied retailers in particular have increased their market share by almost [ ]% over the last five years at the expense of BP-supplied retailers (down [ ]%) and Z (down [ ]%), although a large part of the switch between BP and Mobil is due to Mobil taking over the contract to supply Foodstuffs. Such changes in share are not

147 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to Commerce Commission (11 December 2015) at 3.

what we would expect to see if systemic coordination was occurring everywhere. Changes in market share appear to us to be more consistent with firms undertaking competitive behaviour, rather than coordination.

Table 5: Retail volumes 2011 - 2015[148]

Retail market shares	2011	2012	2013	2014	2015
Z	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Caltex and Chevron-supplied	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
BP and BP-supplied	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Mobil and Mobil-supplied	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Total retail volumes (ML)	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**

Source: Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (12 March 2016)

193. Putting to one side those national changes, we reiterate that we are looking at coordination in local markets. Therefore, what matters are changes in demand at a local level. There is likely to be greater volatility at a local level than at a national level. Z gave the rebuild in Christchurch as an example of where local market conditions can be volatile.[149]

194. In summary, while we do not, and do not expect to see, much innovation in the sense of new products being launched, we do observe that there has been innovation in service and pricing offers in recent years. This type of conduct would make it more difficult to achieve a coordinated outcome, but, perhaps more relevantly, is not conduct that we consider is consistent with firms acting in a coordinated way. The fact that individual market shares have also changed so significantly is difficult to reconcile with a market showing signs that it is vulnerable to coordination.

<u>Firms interrelated through association or cross ownership</u>

195. Structural links can facilitate coordination among firms by reducing the incentive to undercut a rival and providing a forum through which to punish a rival for deviating from the coordinated outcome.

196. As has already been described, New Zealand's fuel market is characterised by shared infrastructure owned and operated by the major fuel firms. As discussed this can lead to some similarity in wholesale costs as highlighted above.

<u>A small number of competitors and the absence of an aggressive competitor</u>

197. Because coordination requires an implicit agreement, the more participants there are in a market, the less likely firms will be able to reach an agreement. One recent

148 Gull sales are the only volumes excluded from these figures. Z estimates Gull's share at [ ]. Annex 1B to e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (10 December 2015.

149 Commerce Commission interview with Z (23 March 2016).

academic paper comments (referring to the experimental economic literature) that "coordination is unlikely with three players and non-existent with four players".[150]

198. Moreover, the presence of a particularly aggressive competitor can prevent a coordinated outcome.

199. As already described, there are a range of different competitors operating at the local retail level across New Zealand. Indeed, between them the major fuel firms directly set the retail price for only around [ ] of sites in New Zealand. As many of the independently-owned sites have different owners, it means there are, in aggregate, hundreds of price setters at the retail level in New Zealand competing in a range of local markets.

200. The remainder of sites are either Gull sites or independents supplied on a wholesale basis. The prices charged by independents will be influenced by the price at which they acquire fuel at the wholesale level and also by any other contractual terms on which they acquire fuel. Nevertheless, independents set their own retail prices and there is evidence that some independents appear able to be more aggressive on price than others.

201. The position of Gull is different. Gull appears to be acting as a significant disruptive force in many of the markets in which it is present, based on its different business model and cost base (discussed above). This impact is reflected in the different prices we see in regions where Gull is present compared to those where it is not. What we observe in general terms is set out below.

    201.1. In the South Island and the Wellington region, Z often sets its board prices at or above MPP. The evidence we have viewed suggests that rivals are less aggressive on board pricing in those areas.[151] Gull is only present in local markets north of Wellington.

    201.2. In areas north of the Wellington region, Z has progressively increased the number of sites that have a board price below MPP. Z refers to these locations as "exception areas". Z's margins tend to be lower in these exception areas than in other areas. Z's pricing below MPP in these areas appears to be in reaction to below MPP pricing by rivals and the subsequent loss of volume by Z. The evidence we have viewed suggests that the brands that are driving these lower prices are Gull and, in some cases, Mobil stations. There are also examples of other independent stations pricing below MPP.

202. We conclude from this that Gull is acting as the type of vigorous competitor that makes coordination very difficult. While other retailers sometimes employ an aggressive pricing strategy, this appears for the most part to be in regions where Gull is also present.

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150 Harrington, J.E., (2012) "Evaluating mergers for coordinated effects and the role of "parallel accommodating conduct" (The Johns Hopkins University Working Paper No. 601) at 661.

151 Z has recognised there is less discounting in the South Island. Commerce Commission interview with Z (26 November 2015).

203. It does not follow from this view that we consider coordination is likely (or is happening) where Gull is not present. It remains the case in many local markets where Gull is not present that there are a number of independent price setters, often three or four or more.

Conclusion on whether local retail markets are vulnerable to coordination

204. As is evident from the discussion above, whether local retail fuel market conditions can be said to be vulnerable to a coordinated outcome is unclear with one exception. Some factors point towards a market vulnerable to coordinated activity between competitors and others do not.

205. The exception is that we consider that local markets were Gull is present are not likely to be vulnerable to coordination. The evidence suggests Gull is acting as a significant competitive force driving prices downwards. We consider it would be very difficult for firms to engineer a coordinated outcome in a local market where Gull is present.

206. For all other local markets, we consider it is unclear, when viewed in the round, whether the market conditions make those markets vulnerable to coordination. As noted, the range of market features we have discussed do not all point in the same direction. Accordingly, we have looked to the evidence of existing market behaviour to inform our view as to whether local fuel markets are vulnerable to coordination.

Is the evidence of market behaviour consistent with a coordinated outcome?

207. We have already referred to some evidence that suggests local markets are not currently coordinated. This includes the fact that Z and other fuel firms have looked to invest in differentiating their service offerings and innovating in their pricing offers, and that we have seen [ ] movements in market share over the last five years. It is hard to reconcile these facts with a coordinated outcome, although we accept that coordination could be less than perfect.

208. We have also examined a range of other information on market behaviour to assess whether local markets are vulnerable to coordination including:

    208.1. the rise in industry margins that has been observed over the past several years;

    208.2. Z's pricing behaviour; and

    208.3. Z's internal documents.

209. We examine each of those in turn below.

Industry margins

210. An indicator of successful coordination would be that profitability/margins are above competitive levels. However, a rise in margins in a market does not prove that coordination is taking place. Margins can also rise in competitive markets. For

example, margins could rise due to increased market demand or increased differentiation.

211. There is no dispute that retail fuel margins have been rising since around 2009 across all markets.[152]

212. However, we do not consider that this is likely to be indicative of a coordinated outcome in markets where Gull is present (for reasons discussed above). For all other market we consider it is unclear whether the increase in margin is indicative of a coordinated outcome. We differ from Dr Walker in this regard. Dr Walker does not consider that Z has offered an adequate explanation for its margin increases, or that reasons other than coordination can fully explain them.

213. We see as relevant the fact that as margins have started increasing all the major fuel firms have increased investment. This has included investment in new retail sites and terminal capacity, and the development of new offers.[153] Z has argued that this behaviour is inconsistent with coordination.[154] We do not consider it is necessarily inconsistent with coordination (although as noted above, investment in service differentiation and off-board discounting would make coordination more difficult), but we do consider that increased investment could explain increasing margins.

214. We accept that it is difficult to precisely and accurately ascribe the margin increases in a cause and effect way to increases in demand, increases in differentiation (which unlike Dr Walker we believe have occurred), investments in new assets etc. We consider those are all possible explanations for the increase in margins.

215. As noted above, Dr Walker's view is that Z has not provided an adequate explanation for the increase in margins. Dr Walker cannot exclude coordination happening in all markets across New Zealand.

216. In contrast, we have reached the view that there are a number of local markets where we consider coordination is unlikely to be occurring (ie, where Gull is present). Yet, Z's margins have increased in these markets as well as in other local markets,[155] and we do not consider those margin increases are due to coordination. We, therefore, cannot be certain that the rise in margins in the regions where Gull is not present is due to coordination.

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152 For example, e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015), [ ] and http://www.mbie.govt.nz/info-services/sectors-industries/energy/liquid-fuel-market/weekly-oil-price-monitoring.

153 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (12 March 2016) at 13, submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2016) at 2, [ ].

154 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (12 March 2016) at 13.

155 Source: Z financial data.

217. We therefore do not place the same weight on or draw the same inferences from the margin increases that Dr Walker does.

MPP

218. We have already addressed how Z's pricing behaviour differs in different regions, ie, its MPP price applies to a large proportion of sites, mainly in areas in the Wellington region and the South Island, while sites tend to be priced lower in other areas. We have considered whether this is indicative of coordination in higher priced areas, which as described above tend to be areas where Gull is not present.

219. The difference in prices between MPP areas and exception areas could potentially be explained by systematic differences in costs across those two sets of areas although Z has indicated that delivery costs [ ] across regions.[156] Our analysis of Z's financial data suggests differences in costs only partially account for the difference in price.

220. While we cannot conclude simply from differences in price that a coordinated outcome is occurring, we accept that it is possible that the price differences may be indicative of coordination in local areas where Gull is not present. Conversely, it may simply be evidence of Z having to respond to a more aggressive lower cost competitor in Gull in some local markets; it does not follow that there is coordinated conduct in other markets.

221. We therefore turn to Z's internal documents to see whether they could shed light on whether these price differences were the outcome of coordination.

Z's internal documents

222. We reviewed over 600 Z internal documents relating to its pricing decisions. These included: e-mails between managers responsible for pricing; strategy papers presented to the Z Board; and monthly retail market reviews by management.

223. We looked for evidence of communications consistent with coordination. If there was an implicit agreement to coordinate between Z and its rivals we might expect to see in Z's documents:

    223.1. Z or another competitor acting as a leader with rivals following;

    223.2. Z being able to anticipate how its rivals will react to any price changes; and

    223.3. Z monitoring any cheating on the agreement, and taking action to punish that cheating.

224. Dr Walker concludes that Z's internal documents provide evidence of a leader-follower pricing pattern. This conclusion is based on documents that show that fuel firms are following each other's price changes rather than competing the prices down; that Z monitors its rival's reactions to price changes and, if its price change is

[156] Commerce Commission interview with Z (23 March 2016).

not followed, Z returns its pricing to the previous price level, which Dr Walker interprets as punishment; and that Z is seeking to take a leadership role in price changes (up and down).

225. In contrast to Dr Walker, we consider it is difficult to determine whether any particular documents reflect coordinated behaviour, or reflect competition at work. For example, we would expect any firm in a competitive market to closely consider and monitor the reactions of its rivals to any initiative it undertakes (whether that be pricing or otherwise). Moreover, in the case of retail fuel, a degree of price parallelism can be expected since global fuel prices are a significant part of each firm's cost base and changes in global oil prices affect all firms.

226. The e-mails we reviewed indicated that Z generally sought to lead prices, although sometimes Z did not want to lead price increases and so waited for a rival to move first.[157]

227. Most of these e-mails discussed pricing in exception areas, where we consider coordination is not likely to be occurring and where Gull and/or independent retailers are present. This suggests that the internal discussion may have been generated as Z developed strategies to respond to competitive threats. There were examples in the documents where rivals followed Z's price changes and some where they did not.[158] There were also examples where Z appeared to be able to predict a rival's behaviour but also those where Z was unsure,[159] or where a rival behaved in an unexpected or aggressive manner.[160]
[ ] These examples could be viewed, as Dr Walker views them, as punishment as Z has increased its price and subsequently reverted back to the same price when competitors have not followed, although as we note the decision also could be made to revert to the same price to avoid the loss of market share in a competitive market.

228. The lack of consistency of rivals' reactions and of certainty as to what those reactions might be, further indicates to us that coordination is not occurring in these exception markets. The inconsistency suggests the absence of any implicit agreements between competitors as to how they will interact with one another. For example,

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157 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015) at 1.
[ ]

158 Z internal e-mail [ ] (document ID: ZEN.101.00827) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016).
[ ]

159 Z internal e-mail [ ] (document ID: ZEN.100.03594) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016).
[ ]

160 See for example Z internal e-mail [ ] (document ID: ZEN.101.01068) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2016).
[ ]

which party will lead price movements or that competitors will certainly follow the leader.

229. There are fewer e-mails that discuss pricing in MPP areas. Compared to the exception areas, there are only a few clear examples of e-mails which discuss a rival acting competitively or where there is uncertainty about how a rival may respond to price changes. More usually, the examples in these areas were of Z internally announcing a price change without further commentary. This may suggest that its rivals had followed or were expected to follow, or that Z perceived there to be fewer competitive threats in these areas.

230. Occasional examples of a rival acting competitively or where there is uncertainty about how a rival may respond to price changes does not mean coordination is not occurring. Coordination may not be perfect. We do not, however, find this to be sufficient to consider that coordination is necessarily taking place. It is one factor to be taken into account in the round of our assessment of whether the markets are vulnerable to coordination.

<u>Conclusion on whether there is evidence of coordination in local retail markets</u>

231. We examined the evidence of market behaviour to help us determine whether or not New Zealand's local retail fuel markets are vulnerable to coordination. Our conclusion differs depending on the local market being looked at.

    231.1. In markets where Gull is present, we are comfortable to say that the presence of Gull would mean that coordination is unlikely.

    231.2. In all other local markets, it is unclear whether, viewed in the round, individual local market conditions can be said to be conducive to a coordinated outcome. There are a range of market features, that do not all point in the same direction.

232. The evidence of market place conduct is, in our view, capable of being viewed in different ways.

233. In our view, even the most adverse (to Z and Chevron) interpretation of this evidence leads us only to the conclusion that it is possible that coordination is already occurring in some local markets in the form of an implicit agreement between competitors to accommodate each other's price increases. However, the evidence that would point towards coordination (margin differences, price differences and limited chatter in internal documents) is not strong or unambiguous.

234. Therefore, while we acknowledge that the characteristics of retail markets are such that coordination is possible, there is no clear evidence from which we can suggest with confidence that we are observing coordination in local markets.

235. We now turn to the question of whether, if some local markets are vulnerable to coordination, Z's acquisition of Chevron changes conditions in these local markets so that coordination is more likely, more complete, or more sustainable.

Would the proposed merger make coordination more likely, more complete, or more sustainable?

236. Given the divestments Z has provided, we are satisfied that the removal of Chevron would not materially alter conditions in any local market such as to make coordination more likely, more complete, or more sustainable.

237. We consider it unlikely that the merger would affect the prospects of coordination in local markets where the merged entity competes with Gull. In addition, the merger would not affect the prospects of coordination in local markets where there is no aggregation between Z and Chevron.

238. In the 22 most concentrated local markets where aggregation would occur, the divestments that Z has offered remove the risk that the proposed merger would affect the prospects of coordination, as no aggregation will occur in those 22 markets.

239. In all other remaining local markets (where we have concluded the markets are possibly vulnerable to coordination), Chevron does not appear to be an effective constraint preventing any coordination. The evidence indicates that Chevron is a price follower. This evidence includes:

    239.1. analysis of price data that suggests Caltex stations follow price changes of Z (albeit sometimes with a lag);[161]

    239.2. comments from industry participants that Chevron is a price follower (including Chevron itself and Caltex independent operators);[162] and

    239.3. no examples of Z internal documents identifying Chevron service stations as an aggressor in MPP areas, although some Z stations do price mark Caltex stations.

240. We recognise that the relevant comparison is a comparison between competition with the merger versus competition without the merger, rather than a comparison with competition as it is today. It is possible that absent the merger Chevron may be acquired by a third party who would take a more aggressive competitive approach. However, there is no evidence before us to suggest that it is likely that a new owner would operate the business differently.

241. For these reasons we do not consider that the removal of Chevron from the market would make a material difference to outcomes in local markets priced at or above MPP.

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161 Price data provided by Chevron and Z.

162 Clearance Application from Z (30 June 2015) at [255], Commerce Commission interview with Chevron (2 November 2015) and [ ].

Conclusion on coordinated effects

242. In summary, we conclude that we are satisfied that the merger is not likely to substantially lessen competition in any local market due to coordinated effects. We reach this view because:

242.1. we do not think that the markets where Gull is present are likely to be vulnerable to coordination;

242.2. the merger would have no effect on the prospects of coordination in local markets where there is no aggregation as a result of the merger;

242.3. in the 22 most concentrated of the local markets where aggregation would occur, the divestments that Z has offered remove the risk that the proposed merger would affect the prospects of coordination in those local markets; and

242.4. for all other local markets, it is possible that the markets are vulnerable to coordination (and it is possible that there is coordination already occurring), but Chevron is not playing an important role in constraining any coordination such that the merger would not remove an important obstacle to coordination occurring.

The supply of bitumen

243. This section deals with the impact of the proposed merger on the supply of bitumen.

Background

244. Bitumen is largely used in the construction and maintenance of roads and the production of asphalt.

245. Both BP and Mobil ceased supplying bitumen in New Zealand a number of years ago. Z and Chevron are now the only two suppliers of domestically refined bitumen. Z and Chevron supply three large roading and infrastructure construction companies: Fulton Hogan Limited and Higgins Limited (both being supplied by Z) and Downer New Zealand Limited (Downer) (supplied by Chevron). These three customers make up approximately [ ]% of New Zealand's bitumen demand, with the remainder being supplied to smaller roading contractors.[163]

246. The production of bitumen requires two major steps, extracting from the bituminous crude a heavy residue, and then further refining the residue in a specialised bitumen unit. The initial distillation unit at the refinery is at full capacity, only around two thirds of the capacity of the bitumen unit is being utilised.[164] This is largely because the bitumen storage capacity on the coastal shipping vessel, the Kakariki, which

[163] Clearance Application from Z (30 June 2015) at [172].
[164] E-mail from NZRC to the Commerce Commission (20 October 2015).

delivers bitumen around New Zealand, is fully utilised.[165] Currently, the remainder of demand is met by imports.[166]

247. A replacement ship for the Kakariki is due in mid-2017 and will have approximately double the bitumen carrying capacity of the Kakariki.[167]

Market definition

248. The relevant product market is for bitumen. Other refined fuels are not substitutes for bitumen on the demand or supply-side.

249. Z and Chevron compete to supply bitumen to their customers under nationwide supply arrangements. Consequently, we have adopted a national market for supply of bitumen.

With the merger

250. If the proposed merger proceeds, Z would acquire Chevron's supply agreement with its only bitumen customer, Downer.

251. In addition, Z would acquire Chevron's allocated bitumen processing capacity at the refinery.

Without the merger

252. Z submitted that Chevron intended to exit the bitumen market, leaving Z as the sole domestic supplier regardless of whether the merger was approved.[168]

253. Chevron advised us that absent the proposed merger it would exit the market by December 2016 when its current bitumen supply agreement with Downer is due to expire.[169]

254. This would mean that Z would be the only major supplier of bitumen in New Zealand. Therefore, there would be no difference between the scenario with the merger and the scenario without the merger.

Is there a real chance that Chevron would continue to supply bitumen absent the merger?

255. We reviewed a considerable number of internal documents from Chevron to assess whether Chevron would exit the market with or without the merger.[170] We also reviewed a number of internal documents from Z about bitumen.[171] We concluded

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165 Commerce Commission interview with Chevron (21 August 2015).

166 The level of imports fluctuates over time.

167 Commerce Commission interview with Chevron (21 August 2015).

168 Clearance Application from Z (30 June 2015) at [176].

169 Commerce Commission interview with Chevron (21 August 2015) and Commerce Commission phone call with Chevron (9 March 2016).

170 Documents attached to letters from Buddle Findlay (on behalf of Chevron) to the Commerce Commission (25 September 2015 and 20 November 2015).

171 Documents attached to letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (26 November 2015).

that there was no real chance that Chevron would continue to supply bitumen if the merger did not proceed.

256. We established that Chevron's review of its New Zealand bitumen operations was driven by Chevron's need to declare to COLL by 21 November 2014 whether it intended to carry bitumen on the replacement Kakariki vessel.

257. On 20 November 2014, Chevron gained internal approval to exit the New Zealand bitumen market by November 2016. The evidence shows that Chevron's decision was the result of a lengthy review of Chevron's New Zealand bitumen business that commenced in 2013, before the proposed merger was on Chevron's horizon. There was no discussion of the proposed merger in any of Chevron's internal documents.

258. There were a number of factors in Chevron's decision to exit the supply of bitumen in New Zealand, including the desire to avoid the additional cost of and liability for the replacement vessel for the Kakariki, the value of the New Zealand bitumen business including its purchases of Ratawi crude (which is the preferred crude for bitumen manufacture), and Chevron's uncertainty about the continuation of bitumen production at the refinery.

259. Ultimately, Chevron decided that the costs and risks associated with committing to the replacement vessel outweighed the profit its New Zealand bitumen business was returning.

260. In addition, following a review of the bitumen plant at the refinery, NZRC had in 2014 increased the processing fees for bitumen. Chevron advised that it was unable to pass on all of that increase to Downer and this significantly decreased Chevron's margins on bitumen.

261. During its review of the New Zealand bitumen business, Chevron also considered the enterprise value to its upstream division, Crude Supply and Trading (CSAT), of Chevron New Zealand purchasing Ratawi crude.

262. Ratawi crude is the preferred bituminous crude that Chevron and Z have used (until recently) in the manufacture of bitumen at the refinery. CSAT supplies Ratawi crude to Chevron New Zealand. Z purchases Ratawi from its crude trader SIETCO which in turn purchases Ratawi crude on the spot market. However, since May 2015, Ratawi crude has been unavailable to CSAT due to a dispute between the Saudi Arabian and Kuwaiti governments, on whose behalf Chevron has extracted Ratawi crude from the Wafra oil field.

263. Chevron's documents show that CSAT's supply of Ratawi crude to New Zealand has significant enterprise value to Chevron Inc. We considered whether Chevron might remain in the bitumen market in order to preserve the enterprise value of Ratawi crude absent the merger. We consider this is unlikely because:

263.1. of the current uncertainty about if and when the production of Ratawi crude will be resumed;[172]

263.2. Chevron considers that Z will purchase Ratawi crude on the spot market if its production resumes because Ratawi is the optimal bituminous crude for the New Zealand refinery;[173]

263.3. the New Zealand demand for Ratawi crude is around 1.5% - 3% of global demand (split 40/60 between Chevron and Z) and Chevron advised us that it has other markets in which to sell Ratawi;[174] and

263.4. Chevron has given Downer notice that it will not supply Downer with bitumen beyond the expiry in November 2016 of its supply agreement.[175]

264. In conclusion, for all of these reasons, we are satisfied that there is not a real chance that Chevron would remain in the bitumen market after November 2016, and accordingly there is likely to be no difference between the with-the-merger and the without-the-merger scenarios.

The supply of aviation fuel

265. This section deals with the impact of the proposed merger on the supply of aviation fuel.

Aviation fuel

266. Aviation fuel is a general term for fuel used by aviation customers. Aviation customers range from owners of small aircraft for personal use up to large commercial airlines (such as Air New Zealand which is the biggest customer). There are two different grades or types of aviation fuel, Jet A-1 and Avgas. Avgas is a motor spirit based fuel that is only used by small, light piston engine aircraft. Jet A-1 is a kerosene grade fuel used in larger, turbine engine aircraft. This determination only discusses the supply of Jet A-1 because while Z supplies both Jet A-1 and Avgas, Chevron only supplies Jet A-1. Chevron has not supplied Avgas to date and has no plans to start doing so.[176]

Production and distribution

267. The large majority of Jet A-1 aviation fuel supplied in New Zealand is produced at the refinery, with the remainder consisting of a small proportion of imports. The volume of Jet A-1 produced at the refinery is sufficient to meet over [ ]% of the total demand for Jet A-1 in New Zealand. A small amount (typically [ ]) of Jet A-1 is typically imported into Christchurch and Wellington, although when the refinery has

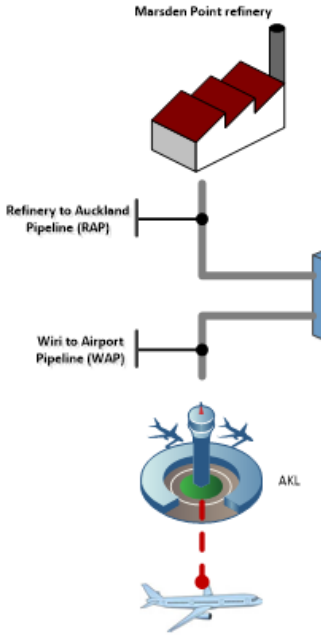
[172] Chevron advised us that it does not know if or when production of Ratawi crude might be resumed. Commerce Commission phone call with Chevron (9 March 2016).
[173] Commerce Commission phone call with Chevron (9 March 2016).
[174] Ibid.
[175] E-mail from Buddle Findlay (on behalf of Chevron) to the Commerce Commission (10 March 2016).
[176] Commerce Commission interview with Chevron (23 September 2015).

a shutdown the volume of Jet A-1 imported increases.[177] There are rare instances of exports of Jet A-1.

268. While Z, BP, and Mobil supply Jet A-1 at multiple locations across New Zealand, Chevron only supplies Jet A-1 at Auckland Airport.[178]

269. Jet A-1 produced at the refinery is delivered to Auckland Airport using infrastructure jointly owned or utilised by BP, Mobil, Z and Chevron, as shown in Figure 5.[179]

Figure 5: Infrastructure used in supplying Jet A-1 at Auckland Airport



At Auckland Airport the following additional infrastructure exists:

- Storage terminal owned by the Joint User Hydrant Installation (JUHI)
- Dispensing units operated by two JVs: Joint Into-Plane Refuelling Services (JIFS) and Joint Ramp Service Operations Agreement (JRSOA)

270. Table 6 sets out data on estimated shares in the supply of Jet A-1 at Auckland Airport by volume (based on figures for 2014).

177 For example the refinery experienced an extended shutdown in 2014. Consequently, imports in 2014 ([ ] million litres) were around double those in 2013 and 2015 ([ ] million litres and [ ] million litres respectively). Source: industry participants' data.

178 Chevron advised that it had not supplied Jet A-1 at other airports in the past and said that it would need additional volume and better margins than at present to justify investment in infrastructure to supply Jet A-1 at other airports. Commerce Commission interview with Chevron (23 September 2015).

179 Given the volumes of Jet A-1 demanded, the infrastructure depicted in Figure 5 is the only feasible way to get Jet A-1 to Auckland Airport. Imported refined product is not able to be supplied to Auckland Airport using this infrastructure except during some refinery shutdowns. Clearance Application from Z (30 June 2015) at [119].

Table 6: Sales of Jet A-1 at Auckland Airport, 2014

Supplier	Volume (litres)	%
Z	[ ]	[ ]%
Chevron	[ ]	[ ]%
Merged Entity	**[ ]**	**[ ]%**
Mobil	[ ]	[ ]%
BP	[ ]	[ ]%
TOTAL	**[ ]**	**100%**

Source: Industry participants

271. The price paid for Jet A-1 consists of two main components:

271.1. a product price for Jet A-1, based on an appropriate Mean of Platts Singapore (MOPS) benchmark which is largely standard across customers; and

271.2. a margin on top of MOPS which is established on an individual customer basis as a result of the specific competitive process used by that customer (eg, a tender).

272. The ultimate price paid by a customer is also affected by the credit terms agreed between that customer and the fuel firm.

273. Outside of Auckland Airport, Jet A-1 is supplied at Wellington Airport by BP and Mobil, and Jet A-1 is supplied at Christchurch Airport by Z, BP and Mobil. These airports are supplied predominantly with domestically refined Jet A-1 shipped from the refinery using COLL, supplemented by some imports.

Market definition

274. The supply of Jet A-1 at Auckland Airport is, for most customers, a bidding market. These customers typically use competitive tender processes to obtain competitive prices.

275. There is limited storage for Jet A-1 transported to Auckland Airport via the RAP and WAP (approximately three days).[180] Therefore, the major fuel firms are under pressure to sell sufficient volumes of Jet A-1 at Auckland Airport or they face the possibility of having to export any leftover volumes to markets offshore. Doing so would incur additional freight costs and that product would have to be priced so as to be competitive with other international Jet A-1 fuel sources. As such, exported Jet A-1 must be priced at export parity prices (where any additional costs of transportation are incurred by the exporting fuel firm). Exports of Jet A-1 are rare and of minimal volume.[181]

[180] Clearance Application from Z (30 June 2015) at [143].

[181] BP exported [ ]. E-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (21 January 2016).

276. An exception to this general bidding market applies to the largest customer at Auckland Airport, Air New Zealand Limited (Air New Zealand). Air New Zealand purchases over half of the total Jet A-1 sold at Auckland Airport.
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277. There is an [ ].[182] This may be because its large volume requirements are subject to different competitive alternatives than are available to all other customers. The strength of those competitive alternatives is explored further below in the competition analysis section. The differences suggest that Air New Zealand could constitute a separate customer market.

278. Therefore, we considered two separate markets:

278.1. sales of Jet A-1 to Air New Zealand at Auckland Airport; and

278.2. sales of Jet A-1 at Auckland Airport to all other (non-Air New Zealand) customers.

279. If a substantial lessening of competition is unlikely in either of these two narrow markets, competition concerns would not be present in a broader Auckland Airport market for sales to all customers.

How the proposed merger could substantially lessen competition

280. We considered both unilateral and coordinated effects that might arise as a result of the proposed merger in either of the two markets identified above.

281. We considered whether the proposed merger would remove a competitor that otherwise provides a competitive constraint on Z such that, post-merger, Z would be able to profitably increase prices and/or lower quality to customers at Auckland Airport.

282. We also considered the proposed merger would increase the potential for Z and its remaining competitors (BP and Mobil) to coordinate their behaviour and collectively increase prices and/or lower service quality in relation to fuel supplied to either Air New Zealand or other customers in these respective markets.

Competition analysis – unilateral effects

283. Z submitted that the proposed merger would not result in any lessening of competition in the supply of Jet A-1 at Auckland Airport in either market. Z submitted that any attempt by it to increase prices post-merger would be

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constrained by competition from BP and Mobil, and the substantial countervailing power of airline customers.[183] Z further submitted that the ability of BP and Mobil to increase their share of Jet A-1 supply would be unaffected by the proposed merger and would provide a likely, timely and sufficient constraint on Z following the proposed merger.[184] Z's view is that BP and Mobil would both be well-placed to expand their sales of Jet A-1 at Auckland Airport in response to any attempt by the merged entity to raise prices.

284. We consider that the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition in the supply of Jet A-1 at Auckland Airport to Air New Zealand or any other customers. This is because BP and Mobil would remain as effective alternatives and competitors to Z post-merger. We discuss each of the markets in more detail below.

Market for customers other than Air New Zealand at Auckland Airport

285. Table 7 sets out data on estimated shares in the supply of Jet A-1 at Auckland Airport to customers other than Air New Zealand (based on figures for 2014).

Table 7: Sales of Jet A-1 to customers other than Air New Zealand at Auckland Airport, 2014

Supplier	Volume (litres)	%
Z	[ ]	[ ]%
Chevron	[ ]	[ ]%
Merged Entity	**[ ]**	**[ ]%**
Mobil	[ ]	[ ]%
BP	[ ]	[ ]%
TOTAL	**[ ]**	**100%**

Source: Industry participants

286. Table 7 indicates that the proposed merger would increase Z's share in the supply of Jet A-1 at Auckland Airport to customers other than Air New Zealand from [ ]% to [ ]% and that the remaining competitors BP and Mobil would, combined, account for [ ]% of the sales. However, these figures do not convey the strength of the constraint provided by BP and Mobil. This is because, within a bidding market context, BP and Mobil are likely to be able to expand sufficiently to compete for and supply any of these customers. Any such expansion is likely to be achieved without incurring any additional costs and so would be profitable at, or close to, current prices.

287. Contracts for the supply of Jet A-1 at Auckland Airport regularly come up for tender, with contracts typically being tendered every one to two years. Evidence on recent tenders shows BP and/or Mobil competing to win tenders for the supply of Jet A-1 at Auckland Airport in most instances where they have been invited to bid. Evidence also indicates that at times fuel firms can be aggressive in their bidding for an airline

183 Clearance Application from Z (30 June 2015) at [146-149].
184 Ibid at [93.3].

contract (eg, by offering a low price to win or retain volume).[185]
[ ]

288. Consequently, market shares in the supply of Jet A-1 at Auckland Airport can change materially following the tender of a large customer contract. In fact, data on sales volumes over the last three years shows that BP has grown its share of sales of Jet A-1 at Auckland Airport. [ ][186]

289. Additionally, tender information obtained from the parties indicates that customer churn is a regular occurrence. For instance, BP has recently won contracts off Z and Chevron. [ ][187] Furthermore, there do not appear to be any substantial barriers to BP and Mobil expanding their sales of Jet A-1 at Auckland Airport to any of these customers.

290. Consistent with this evidence, none of these customers expressed concern that the removal of Chevron would reduce their ability to use competition between Z, BP and Mobil to obtain satisfactory prices.[188]

291. Consequently, we found no evidence to indicate that the removal of Chevron would result in competition for these airline contracts being substantially lessened.

Market for Air New Zealand at Auckland Airport

292. The only customer to raise concerns regarding the impact of the proposed merger on the supply of Jet A-1 at Auckland Airport was Air New Zealand.

293. Table 8 sets out data on estimated shares in the supply of Jet A-1 at Auckland Airport to Air New Zealand (based on figures for 2014). Z and Chevron are [ ] of Jet A-1 to Air New Zealand currently, with each having a [ ]% share of sales by volume. Combined, Z and Chevron supply [ ]% of Air New Zealand's demand at Auckland Airport.

185 [ ]
186 [ ]
187 [ ]
188 [ ]

Table 8: Shares of sales of Jet A-1 to Air New Zealand at Auckland Airport, 2014

Supplier	Volume (litres)	%
Z	[ ]	[ ]%
Chevron	[ ]	[ ]%
Merged Entity	**[ ]**	**[ ]%**
Mobil	[ ]	[ ]%
BP	[ ]	[ ]%
TOTAL	**[ ]**	**100%**

Source: Industry participants

294. Air New Zealand raised concerns that its supply of Jet A-1 would be concentrated in the merged entity and that its ability to switch volumes between fuel firms is limited. Air New Zealand submitted that because of the way that capacity is allocated across fuel firms at the refinery, there is limited prospect of large changes in market share.[189] [190]

295. Air New Zealand further submitted that reducing the number of suppliers from four to three would reduce its ability to switch volumes away from the merged entity post-merger.[191] Air New Zealand [ ].[192]

296. Air New Zealand's main concern is that, post-merger, it would have significant difficulty in shifting volume away from the merged entity and having its volumes split evenly across the remaining major fuel firms (Z, BP and Mobil). Air New Zealand considers that [ ].[193] To achieve this even split, Air New Zealand would need to increase purchases from BP and Mobil by around [ ] litres each. We use these amounts below as proxies for the level of expansion by BP and Mobil that would be necessary to constrain Z, whilst noting that the actual amounts by which BP and Mobil could physically expand are greater.

297. For the reasons set out below, we consider that it is likely that the ability for Air New Zealand to switch volumes away from the merged entity would not be diminished to the point that it could not discipline a substantial potential price increase above the current level it faces from Z.

189 Submission from Air New Zealand to the Commerce Commission (7 October 2015).

190 See the industry background section for more detailed discussion of allocation of capacity at the refinery.

191 Submission from Air New Zealand to the Commerce Commission (7 October 2015).

192 Letter from Air New Zealand to the Commerce Commission (22 September 2015) and e-mail from Air New Zealand to the Commerce Commission (4 December 2015).

193 Commerce Commission interview with Air New Zealand (24 August 2015).

298. Absent an increase in BP and/or Mobil's overall capacity allocation at the refinery,[194] there are three mechanisms by which BP and/or Mobil could increase their supply to Air New Zealand:

298.1. BP and/or Mobil could reduce the volumes of domestically refined Jet A-1 which they currently sell in Wellington and Christchurch and re-direct those volumes to Auckland Airport via the RAP and WAP. BP and/or Mobil could replace those re-directed volumes with additional imports into Wellington and Christchurch. We refer to this approach as a "divert and import" strategy;

298.2. BP and/or Mobil could increase the amount of Jet A-1 they produce domestically at the refinery by reducing the amount of diesel they produce.[195] We refer to this as an "adjust product mix" strategy; and

298.3. BP and/or Mobil could increase sales to Air New Zealand by foregoing sales to other customers when these supply contracts expire and instead divert those volumes to Air New Zealand. We refer to this as a "switch customers" strategy.

299. In practice, BP and/or Mobil could employ a combination of all three of these strategies, particularly as the timing and magnitude of any increase in the supply of Jet A-1 to Air New Zealand that is possible from each of these strategies would likely differ.[196]

300. The divert and import strategy and adjust product mix strategy would both involve BP and/or Mobil sending greater volumes of Jet A-1 down the RAP and WAP to Auckland Airport. Having considered the total capacity of those pipelines and rules around how that capacity is allocated, we are satisfied that there is no constraint on BP and/or Mobil sending greater volumes of Jet A-1 down the RAP and WAP to Auckland Airport.

Divert and import strategy

301. Several key considerations are relevant to the viability of a divert and import strategy. The first is whether BP and/or Mobil would have the ability to expand to a sufficient degree at Auckland Airport. That is, there must be sufficient volume of domestically refined Jet A-1 sold outside of Auckland Airport by BP and Mobil to enable them to viably divert those volumes to supply Air New Zealand at Auckland Airport. The amount of domestically refined Jet A-1 sold outside of Auckland Airport

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194 As noted earlier, capacity is allocated at the refinery in proportion to each fuel firm's rolling three-year market share. If BP or Mobil's share of refinery capacity were to increase, this would (with no adjustment to imports, product mix or customers) likely result in that fuel firm's production of Jet A-1 increasing.

195 This could occur by altering the mix of crude oil they have refined at the refinery and/or altering the "cut point" between diesel and Jet A-1 at the refinery so as to produce proportionately more Jet A-1 and less diesel from a given crude type.

196 We understand that a divert and import strategy could be implemented within [ ]. A switch product mix strategy could take [ ]. Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (1 March 2016) and [ ]. A switch customer mix strategy would be dependent on when other existing contracts are re-tendered, most of which have durations of one or two years.

by BP and Mobil in 2015 was around [ ] million litres and [ ] million litres, respectively, meaning that BP and Mobil could divert a material amount.

302. [

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303. Our concern is whether a divert and import strategy could be implemented for a sufficient volume of imports to effectively constrain Z from substantially raising prices. It is not necessary that Air New Zealand be able to re-direct all of the volumes it obtains from Z to BP and Mobil for Z to be effectively constrained.

304. If the maximum amount of domestically refined product sold outside of Auckland Airport were to be diverted to Auckland Airport under a divert and import strategy by both BP and Mobil, whilst maintaining supply to all their other existing customers and their current production mix, BP and Mobil together would be able to increase supply to Air New Zealand at Auckland Airport by an amount in the vicinity of [ ] million litres. Combined with their current sales to Air New Zealand, the total that they could supply Air New Zealand at Auckland Airport would be around [ ] million litres ([ ]). Under this scenario [ ].[197]

305. We do not consider that Z would likely find it profitable to risk losing sales of [ ] million litres in order to raise the price [ ]. The [ ] million litres account for about [ ]% of Z and Chevron's combined Jet A-1 sales at all airports based on 2014 sales.[198]

306. The second consideration is whether BP and/or Mobil would have an incentive to divert some proportion of these volumes and replace them with additional imports. This depends on the cost that BP and/or Mobil would incur in importing additional volumes of Jet A-1 and the price these firms would obtain if they supplied these imports to other customers in Wellington and Christchurch.

    306.1. Z submitted that the cost of increasing imports would be economic at current prices and could be achieved with existing storage infrastructure being supplied by imports using combination cargo vessels.[199]

    306.2. In contrast, BP stated that [ ].[200] BP stated that
    [

[197] Source: industry participants' data.

[198] Source: industry participants' data.

[199] Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (1 March 2016) at [12.2].

[200] E-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (23 March 2016) and e-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (1 April 2016).

].[201]

306.3. Mobil stated that it would consider possible commercial opportunities to expand imports, [ ].[202]

307. [ ], we considered whether current Jet A-1 pricing could inform us as to the likely viability of BP and Mobil increasing imports to Wellington and Christchurch to supply additional volume to Air New Zealand as part of a divert and import strategy.

308. We consider that the prices that Air New Zealand faces for Jet A-1 at Auckland Airport are likely to be within, or at, two bounds. The lower of these two bounds is the export parity price level. Below this level the fuel firms would be unwilling to supply Jet A-1 to Air New Zealand at Auckland Airport because they could earn a greater return from exporting. Provided there is sufficient domestically refined fuel currently sold at import ports so as to allow for a divert and import strategy (as discussed above), the upper bound is the import parity price level. Prices above this level would not necessarily be sustainable because fuel firms would be incentivised to increase sales to Air New Zealand at Auckland Airport because additional sales facilitated by additional imports would be profitable. Air New Zealand would therefore be able to credibly threaten to switch volumes between the fuel firms to constrain prices down to at least import parity prices.

309. We consider that the prices that Air New Zealand faces from Z, BP and Mobil at Auckland Airport are based on the import parity price level.
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310. [

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[ ][203]

[201] E-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (23 March 2016) and e-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (1 April 2016).

[202] E-mail from Mobil to the Commerce Commission (16 March 2016).

[203] Chevron internal documents provided under cover of e-mail from Buddle Findlay (on behalf of Chevron) to the Commerce Commission (26 February 2016) and e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (9 February 2016).

311. [ ][204]

312. [ ][205]

[ ][206]

313. No new storage infrastructure would be required by BP or Mobil at Wellington or Christchurch to implement the divert and import strategy as described above. This is because the additional imports needed by BP and/or Mobil to implement this strategy would be no greater than the amount of domestically produced Jet A-1 currently shipped by COLL to Wellington and Christchurch as part of COLL's combination cargo vessels. Additionally, [ ]. This suggests that increasing imports by way of combination cargoes to Wellington and Christchurch would be an economically viable method for BP and/or Mobil to expand sales to Air New Zealand at Auckland Airport by at least the [ ] litres Air New Zealand considers is desirable to [ ].

Adjust product mix strategy

314. Regarding the viability of an adjust product mix strategy, Z submitted that the amount of Jet A-1 that BP and Mobil would be incentivised to produce at the refinery could be substantially greater than their current levels.[207]

315. In contrast, BP stated that [ ].[208] Mobil

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204 [ ]

205 Chevron and Z internal documents suggest that [ ].

206 [ ]

207 Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (1 March 2016) at [16].

208 E-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (23 March 2016) and e-mail from Simpson Grierson (on behalf of BP) to the Commerce Commission (1 April 2016).

[
].[209]

316. We consider that it is unclear whether the additional costs, including opportunity costs, associated with BP and/or Mobil significantly switching their production mix at the refinery away from diesel and towards Jet A-1 would be substantial. Therefore, although this strategy may be profitable to some degree, and may allow some scope for BP and/or Mobil to increase Jet A-1 production, we are not satisfied that this strategy on its own would necessarily allow a sufficient expansion to constrain Z post-merger.

Switch customers strategy

317. In relation to the switch customers strategy, price data we have obtained indicates that, [ ],[210]
[
].[211]

318. [
]

319. If BP and Mobil were to each switch to supplying only Air New Zealand at Auckland Airport and forego all their other current customers, without also implementing divert and import or adjust production mix strategies, they would be able to supply Air New Zealand around [ ] million litres
([ ]).[212]

Air New Zealand's buying strategy

320. Air New Zealand [ ].[213]
[ ][214]

321. Although Air New Zealand has stated that
[ ],[215]

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209 E-mail from Mobil to the Commerce Commission (16 March 2016).

210 Air New Zealand commented that [ ]. Commerce Commission interview with Air New Zealand (24 August 2015).

211 Appendix J to e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (26 November 2015) and e-mail from Buddle Finlay (on behalf of Chevron) to the Commerce Commission (27 November 2015.

212 Source: industry participants' data.

213 [
] E-mail from Chevron to Air New Zealand (27 September 2013).

214 E-mail from Air New Zealand to the Commerce Commission (4 December 2015).

215 Commerce Commission interview with Air New Zealand (30 March 2016).

we consider that if Z were to increase prices, Air New Zealand would seek to shift volumes to BP and Mobil. In this situation Air New Zealand may not need to actually switch volume in order to benefit from competition between Z, BP and Mobil. Rather, the threat of switching may be sufficient to constrain Z.

322. This is particularly so if the volume for which Air New Zealand [ ]. The more that both BP and Mobil are able and incentivised to expand supply to Air New Zealand using a combination of all three strategies outlined above, the more likely that volume is to be small. In fact if BP and Mobil were to implement combinations of all three strategies it would be possible for them to [ ]. BP and Mobil's total combined production of domestically refined Jet A-1 is around [ ] million litres whereas Air New Zealand's total purchases at Auckland Airport are around [ ] million litres.[216]

Conclusion on ability and incentive of BP and/or Mobil to expand

323. Based on the above analysis and evidence, we consider that, in response to a post-merger increase by Z in the price it charges Air New Zealand, BP and/or Mobil would have the ability and incentive to materially increase the volume of Jet A-1 they supply to Air New Zealand at Auckland Airport within a reasonably short timeframe and without substantial additional cost. We are satisfied that this ability and incentive to expand would be sufficient in extent in a timely fashion so as to constrain Z and mean that the lessening of competition in the supply of Jet A-1 to Air New Zealand at Auckland Airport would not be substantial.[217]

[ ] Chevron's and Z's prices to Air New Zealand post-merger

324. Although we do not consider that the merger would lessen competition to the extent that Z would be able to substantially increase prices to Air New Zealand above current levels, we assessed whether the merger could allow Z to [ ].

325. Table 9 sets out data on each fuel firms' annual average pricing to Air New Zealand at Auckland Airport for international flight operations.[218] The pricing is specified as a margin or differential in US cents per gallon (added on top of the MOPS product cost).

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216 Source: industry participants' data.

217 [ ] Commerce Commission interview with Air New Zealand (30 March 2016).

218 [ ]

Table 9: Annual average pricing to Air New Zealand at Auckland Airport

Supplier	Margin on top of MOPS (US cents/gallon)		
	2013	2014	2015
Z	[ ]	[ ]	[ ]
Chevron	[ ]	[ ]	[ ]
Mobil	[ ]	[ ]	[ ]
BP	[ ]	[ ]	[ ]

Source: Industry participants

326. Table 9 shows that
[
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327. [
]

328. [
][219]

329. [
][220]
[
][221]

330. [
]

219 [
]

220 All New Zealand dollar figures are based on an exchange rate of NZ$1: US$0.69.

221 [
]

331. We note that, to the extent that Z supplies a smaller amount of Jet A-1 outside of Auckland Airport than BP and/or Mobil and that Z does not supply Jet A-1 at Wellington Airport (unlike BP and Mobil), it may be relatively more "desperate" than BP or Mobil to sell Jet A-1 at Auckland Airport. Consequently, this may further limit the incentive Z would face to increase prices to Air New Zealand to some degree.

Competition assessment – coordinated effects

332. Air New Zealand also raised a concern that if the proposed merger proceeds, the potential for coordination within the industry would increase.[222]

333. We consider that coordinated effects from the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition in the supply of Jet A-1 at Auckland Airport.

334. The infrastructure used by fuel firms to supply Jet A-1 at Auckland Airport is owned by the fuel firms under various joint ventures (eg, JUHI, JIFS and JRSOA) requiring them to interact with each other about operational and investment decisions. Post-merger, Z would have an interest in one more joint-venture at Auckland Airport than is currently the case (being the JRSOA into-plane refuelling joint venture between Chevron and Mobil). However, we do not consider that this would materially increase the potential for coordination. This is because there are other forums through which Z already interacts with Mobil and Z would only obtain limited non-sensitive Mobil information from its participation in the JRSOA.[223]

335. We similarly do not consider that there is a materially increased risk of the fuel firms coordinating on airline tenders. We reviewed internal Z and Chevron documents on tenders for airline contracts over the last three years. We found one instance in which a Chevron internal document suggested that it had not sought to expand sales to Air New Zealand in case it would face more aggressive bidding by other fuel firms in tenders for other customers in response. However, we found insufficient evidence to support a view that fuel firms more generally seek (through tender processes) to ensure that each firm has contracts to sell at least their minimum amount of Jet A-1, so that no fuel firm becomes desperate and drives down margins. Instead, the documents indicated that the fuel firms were typically competing vigorously on price to win Jet A-1 customer contracts at Auckland Airport.

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222 Submission from Air New Zealand to the Commerce Commission (7 October 2015).

223 The JIFS (into-plane refuelling joint venture between Z and BP) and JRSOA both operate in accordance with a set of core principles which provide for (amongst other things) minimal sharing of information between competitors, the segregation of staff involved in the joint ventures from sales and marketing activities, the appointment of different representatives to different joint ventures, and the provision of regular competition law compliance training. Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (23 October 2015) and e-mail from Buddle Findlay (on behalf of Chevron) to the Commerce Commission (1 December 2015).

The supply of petroleum products to commercial customers

336. This section deals with the impact of the proposed merger on the bulk supply of petroleum products to commercial customers. We separately consider the supply of diesel to commercial customers at truck stops in the subsequent section.

337. As a result of the proposed merger, the competition between Z and Chevron for bulk commercial customers would be lost. However, we consider that the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition in the supply of petroleum products to commercial customers, including those serviced through fuel resellers. This is largely because sales to larger bulk customers tend to be made through a tender or negotiation process and we do not consider Chevron to be a more cost effective or otherwise preferred option to BP and Mobil, who would remain as competitive alternatives to Z. Further, BP and Mobil are not significantly constrained in their ability to expand their supply.

338. In regard to sales to smaller bulk customers by way of resellers, Z and Chevron resellers do not have any particular infrastructure or service quality that makes them closer competitors or that would otherwise provide them with an advantage over either BP's or Mobil's resellers. Resellers are incentivised to increase the volume of their sales, and there are limited barriers to small bulk customers switching their supplier.

Background

339. Many commercial customers receive direct deliveries of petroleum products from a terminal to their own storage facility (known as a 'bulk delivery'). Customers of bulk deliveries range from large commercial users who fuel their transport fleets and heavy equipment from their own storage depots, to small rural farmers, who have a storage tank on the farm. The vast majority of this fuel is diesel.[224]

340. The major fuel firms supply some of these bulk customers directly while other bulk customers are supplied through a reseller (also known as a distributor). To date, Gull has only competed to a limited degree with the major fuel firms to supply bulk commercial customers and it does not have a reseller.[225] Resellers effectively operate as the major fuel firms' route to market for small bulk commercial customers. This is shown in Figure 6 below. The major fuel firms each have a wholesale supply arrangement with a reseller and, in some cases, several resellers.

    340.1. The major fuel firms tend to deal directly with the larger volume customers because they are in a better position to arrange deliveries of large quantities of fuel to multiple locations on the best commercial terms.

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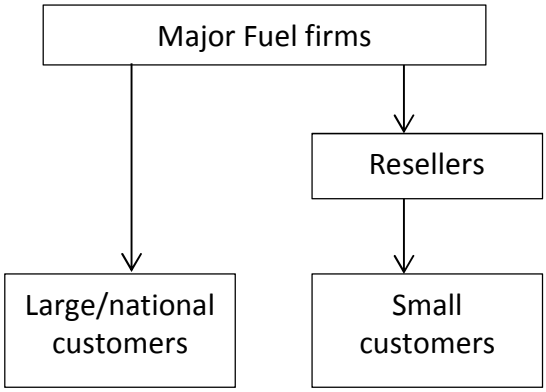
[224] Although commercial customers also purchase petrol, these account for only a small proportion of total purchases. For this reason we focus on diesel.

[225] Gull currently supplies approximately [ ] of fuel to commercial customers from its Mt Maunganui terminal. It considers itself to be an insignificant competitor for these types of customers because it is limited by its existing footprint and customers' preference to be supplied from multiple locations. Commerce Commission interview with Gull (4 September 2015).

340.2. Resellers tend to supply smaller bulk customers (such as farmers and small industrial users) because they tend to be logistically more difficult to serve, involving infrequent, low volume orders, and this requires a more specialist transportation service that resellers often provide themselves.

Figure 6: Bulk commercial sales



341. The major fuel firms have slightly different approaches to the types of bulk customers they serve directly.

341.1. Chevron's current approach is to only compete directly for those bulk customers that can accept deliveries of full tankers. All other bulk customers are directed to its reseller, Farmlands, which supplies a range of large and small bulk customers. Chevron itself has [ ] direct bulk customers and some of these customers are also resellers themselves.[226]

341.2. Z has around [ ] direct customers and also owns an operation called Minitankers that provides an onsite refuelling service. Z also supplies the reseller Southfuels that supplies small customers.[227]

341.3. BP supplies bulk customers either directly or through its resellers. It has supply agreements with a range of regional resellers that together cover all of New Zealand. BP typically coordinates the delivery to those customers that require deliveries across multiple sites and in multiple regions.

341.4. Mobil competes for large bulk customers directly, although the delivery of this fuel across the country is contracted to its reseller (Allied). Mobil's different resellers, including Allied, also supply smaller bulk customers. Mobil has resellers that cover all regions of New Zealand.

342. The major fuel firms will often compete for large bulk customers through a tender process. The customer will set out its requirements and the fuel firms will compete to offer the best terms. Depending on the customer, the length of contract negotiated can vary significantly. The core service offered is the direct delivery of

[226] E-mail from Buddle Findlay (on behalf of Chevron) to the Commerce Commission (5 August 2015).

[227] Z volumes and revenue data attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (12 November 2015).

diesel from a terminal to a storage tank. However, the customer may have specific delivery requirements regarding reliability or timeliness that could affect who it chooses as its supplier. In some cases, the fuel firms will provide an itemised breakdown of each cost component of the bid.

343. Smaller bulk customers supplied through resellers are less likely to conduct formal tenders but instead will approach each reseller to obtain a price. Resellers take into account a number of considerations in pricing to small bulk customers, including the location of the customer, annual volume purchased, level of competition in the region, and whether the customer requires the reseller to install storage facilities.

How the proposed merger could substantially lessen competition

344. The major fuel firms compete directly or indirectly (through their resellers) to supply diesel to bulk commercial customers. Our assessment focussed on the unilateral effects that could result from the proposed merger. We assessed whether there are circumstances where Z and Chevron are each other's closest competitors such that the proposed merger would allow Z to profitably raise prices above the level that would prevail without the merger.

345. We do not consider that the proposed merger is likely to raise coordination issues in the supply of diesel to bulk commercial customers as the market features are unlikely to be conducive.[228]

Market definition

346. We defined separate markets for:

346.1. the large bulk commercial customers that purchase diesel directly from the major fuel firms; and

346.2. the smaller bulk customers that purchase diesel through resellers.

347. There is, however, likely to be overlap between these markets and the different types of customers.

Competition analysis – bulk customers that purchase directly

348. The major fuel firms compete to directly supply some large volume customers, including resellers.[229] This competition typically takes place by way of a tender process or negotiation where customers use competitive tender processes to obtain competitive prices. Although Chevron only supplies [ ] of bulk customers directly, we considered the options available for both existing and potential

[228] This is because: purchases involve large contracts; prices are not transparent; there do not appear to be discrete groups of customers that the firms could easily coordinate on; we do not see a clear trend of high market share where firms own terminals; and there is little evidence to suggest existing coordination on customers as most of the customers we spoke with had several bidders for their business.

[229] Unlike some commercial bulk customers, who regularly tender their contracts, resellers tend to be closely aligned with one of the major fuel firms. All the main resellers are in long term contracts with one of the major fuel firms and, in the past, there have been limited examples of resellers switching between the major fuel firms.

customers and whether Z and Chevron may be particularly close competitors for certain types of customers. This may be the case where Z and Chevron have lower costs to supply some customers.

349. However, we did not identify any cost components that appeared to give a significant advantage to one major fuel firm over the other.[230] Further, all of the major fuel firms have an established presence throughout New Zealand and are not significantly constrained in their ability to expand the amount of diesel they supply directly to bulk commercial customers. In general, Z's and Chevron's bulk customers that we spoke to were satisfied they had alternative supply options.

Competition analysis – bulk customers that purchase via resellers

350. Resellers compete to supply small bulk commercial customers with fuel wholesaled to them by one of the major fuel firms. All of the major fuel firms have a reseller in almost every region in New Zealand. For bulk customers supplied by resellers, Z and its related resellers would be constrained by the presence of resellers supplied by BP and Mobil.

351. Table 10 lists the proportion of diesel that is drawn down by the main resellers from each terminal. This table indicates that each of the resellers, in terms of market share, have their own regional strengths and weaknesses.

Table 10: Share of diesel drawn down by resellers from terminals in 2014[231]

Terminal	Z resellers (Southfuels)	Chevron resellers (Farmlands, McKeown)	Merged entity	Mobil resellers (Allied, Wealleans, NPD, Waitomo)	BP resellers (RD, Rural Fuel, McFall, Toll)
Marsden Point	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Wiri Terminal	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Mt Maunganui	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Napier	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
New Plymouth	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Wellington	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Nelson	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Christchurch	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Timaru	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Dunedin	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%
Bluff	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%

Source: Industry participants

352. We identified four regions where the Z and Chevron resellers have a higher proportion of sales than other resellers. These regions were where customers were supplied with diesel drawn from the terminals at Marsden Point, Timaru, Dunedin

230 As noted earlier, we do not consider that the proposed merger of Z and Chevron's terminal facilities would impact BP and Mobil's competitiveness in downstream markets.

231 Percentages based on volume of diesel drawn down by each reseller. Figures exclude volumes delivered to retail sites and truck stops. Farmlands' figures include any sales made to large bulk customers so may overstate Farmlands position relative to other resellers.

and Bluff. In all of these four regions, as well as in other parts of the country, the Z and Chevron resellers do not have any particular infrastructure or service quality that makes them closer competitors or that would otherwise provide them with an advantage over either BP's or Mobil's resellers. That is, despite some resellers having a relatively smaller presence in some regions, BP's and Mobil's resellers are not in a lesser position to supply these customers.

353. Unlike for large bulk customers, sales to small bulk customers are not typically made via a tender process and customers do not tend to enter into fixed supply contracts. Customers are relatively free to change resellers, if incentivised, and the costs to small bulk customers of switching between different resellers appear relatively low.

354. Moreover, all existing resellers have wholesale supply arrangements in place with a major fuel firm and they are incentivised to grow their volume, as this increases their ability to negotiate more favourable terms with their fuel supplier. No reseller identified any significant issues in increasing the current volumes of fuel they obtain from their supplier.

The supply of diesel to commercial customers at truck stops

355. This section deals with the impact of the proposed merger on the supply of diesel to commercial customers at truck stops.

356. We consider that the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition in the supply of diesel to commercial customers at truck stops. Competition for the different types of customers is similar to bidding markets where firms compete for different types of customers by offering discounts off pump prices and by granting access to a network of truck stops. No one supplier appears to have a network or service offering that is preferred over another.

357. Post-merger, at national and regional levels and at all local levels except Kawerau, Z would be constrained by the presence of truck stops operated by BP, Mobil or by one of Mobil's resellers. These firms do not appear constrained in their ability to increase supply. In Kawerau where local truck stop customers would have no clear alternative to the merged entity, we accepted a divestment remedy from Z.

Background

358. Truck stops are distinct from service stations in that they are typically unmanned sites that can be easily accessed, at any time, by customers with a large truck (or other type of large vehicle). Because they are unmanned sites, customers gain access to the site by obtaining an access card from one of the major fuel firms.

359. Each of the major fuel firms has a network of truck stops that span the country. The locations of their truck stops vary geographically. This means that although the major fuel firms are represented across the country and in each region, there may be some areas where one or more of the firms do not have truck stops. Most of the major fuel firms operate their network of truck stops under their own brands but Mobil also

utilises the networks of its resellers. The approximate number of truck stops for each major fuel firm is listed in Table 11.

Table 11: Number of truck stops in New Zealand in 2015

Major fuel firm	Truck stops	Share (%)	Banner
Z	96	30%	All Z sites
Chevron	71	22%	All Caltex sites
Merged entity	**167**	**52%**	
BP[232]	54	17%	All BP sites
Mobil[233]	89	27%	Includes: 12 Mobil, 43 Allied, 25 Waitomo, 8 NPD and 1 Wealleans.
Total	**324**	**100%**	

Source: Industry participants

360. Commercial truck stop customers' travel patterns are complex and the extent of a truck stop network required by each customer also varies.

360.1. There are many customers requiring a national network because they are regularly transporting goods up and down the country, mostly along State Highway One (these are typically line haul transportation companies). As trucks can drive long distances on a single tank (up to 500km),[234] they have the option of many different truck stops along the route.

360.2. There are customers whose operations occur within regions. These customers appear to be more reliant on sites in a particular location, which means their alternatives may be more limited compared to national customers.

360.3. There are some customers whose operations are confined to a local area and therefore only use one or two truck stops. There are very few such customers.

361. Customers will normally negotiate directly with the fuel firms to set up an account to use that firm's truck stop network. The major fuel firms set a pump price for their truck stops. Truck stops are not generally priced on a site-by-site basis but instead are priced over a region or even on a national basis. In most cases the customer will negotiate a discount from the pump price. This discount is affected by the volumes that the customer purchases and in some instances the location of the truck stops they are using. The customer will normally pay the same price wherever they fill up. For some large customers, major fuel firms will offer a cost-based price, which breaks the price down to various components.

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232 BP also supplies the GAS network with diesel. GAS has 14 GAS sites that offer truck stop facilities. Service stations workbook attached to an e-mail from GAS to the Commerce Commission (16 July 2015).

233 Mobil only has one site that it classifies as a stand-alone truck stop but it has some sites that are the equivalent of a stand-alone truck stop. Commerce Commission interview with Mobil (30 September 2015). It also has additional co-located sites and these sites are discussed below.

234 We understand that the average range of a truck on a single fill can be between 400-500km. For example, see Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (23 October 2015) and [ ].

362. As customers will often get a better deal with higher volumes, they are incentivised to use a single supplier of truck stops. However, customers will often carry multiple cards in case their preferred supplier does not have a truck stop in a location they are visiting.[235]

363. Most truck stops are standalone facilities specifically designed for trucks. Others are "co-located" on the same site as a retail service station. Co-located sites are those that are adjacent to a service station but have diesel pumps that can be easily accessed by large vehicles, including those trucks with trailers.[236] However, not all co-located sites have equally good access: some are designed to accept all types of trucks, whereas some are not suitable for large truck-and-trailers.[237] We have assessed the constraint that co-located sites provide on a case-by-case basis.

How the proposed merger could substantially lessen competition

364. Post-merger, Z would own and control a greater proportion of the truck stops throughout New Zealand. Our assessment considered the unilateral effects that could result from the proposed merger for national, regional and local customers. In doing so, we assessed whether there are any areas in New Zealand where Z and Chevron are each other's closest competitors and where there did not appear to be strong alternatives for any existing truck stop customers.

365. We do not consider that the proposed merger is likely to raise coordination issues in the supply of diesel to commercial customers at truck stops. The main reason for this is that the prices to customers are generally established through bilateral negotiation and are not transparent.

Market definition

366. We considered separate markets for customers who have national, regional and local requirements. This is because these different types of customers tend to have different requirements and face different alternatives.[238]

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235 Z estimates that at least [ ]% of its existing customers currently use at least one secondary card. Clearance Application from Z (30 June 2015) at [194].

236 That is, the pumps used by truck stop customers are separate to those used for the retail service stations (such as those under the canopy of the retail forecourt). For example, truck stop card customers are typically penalised for using diesel pumps on the forecourt of a service station.

237 For example, in addition to its truck stop equivalent sites, Mobil has a large number of sites that can be accessed by certain large vehicles. For example, NPD lists on its website over 100 Mobil sites that have large vehicle access. Also see service stations workbook attached to an e-mail from Mobil to the Commerce Commission (5 October 2015).

238 We note that the Office of Fair Trading (OFT) has also considered a similar customer distinction in such markets. For example Shell UK Limited's proposed acquisition of 253 petrol stations from Consortium Rontec Investments LLP See (OFT case ME/5191/11, 3 February 2012). In this case, the OFT considered it appropriate to assess competition at both a national and a regional level for commercial fuel cards for heavy good vehicles.

Competition analysis

367. Post-merger, at a national level and at different regional levels, Z would be constrained by the presence of truck stops operated by BP, by Mobil or by one of Mobil's related resellers.

368. This is because competition for both national and regional customers takes place around the ability to offer a network of truck stops, rather than specific locations. Both BP and Mobil have established truck stop networks across the country. In addition, competition is similar to a bidding market where firms compete for customer accounts by offering discounts off a pump price. While the merger would remove Chevron as an independent competitor, no one supplier appears to have a network or service offering that is preferred over another, and the remaining networks operated by BP and by Mobil (and its resellers) are not significantly constrained in their ability to supply national and regional truck stop customers.

Assessment of local markets

369. When we considered competition at a local level, we used filtering maps to identify those locations where the proposed merger would cause a reduction in the number of competing truck stop brands from three to two or two to one in a local area (such as a town).[239]

370. From this filtering process, we identified nine local areas of potential concern. For these areas we conducted more in-depth analyses such as the nature of customer driving patterns and potential entry. We also spoke to customers that used those truck stops to see if they had concerns.

371. Following this further investigation, we are satisfied that the proposed merger is unlikely to adversely affect competition for local truck stop customers in all these local areas except Kawerau. In all local areas, except Kawerau, either BP or Mobil (including its resellers) have an existing truck stop that a customer could reasonably access if it did not wish to use a truck stop of the merged entity. There are very few areas where the merged entity would be the only option and we were less concerned in some of these areas, compared to our retail analyses, for the reasons set out below.

    371.1. Trucks can travel long distances between refuelling (up to 500km), which provides greater options of where to fill up compared to a retail customer. As such, our filtering exercise was relatively conservative, even when assessing the impact on local customers.

    371.2. The barriers to entry for establishing a truck stop are lower than for a service station. Truck stops tend to be more basic (they are unmanned) and less sensitive to specific locations within a town (such as in a particular suburb or business district). We understand that a new site can be established at

[239] We used a map filter to identify the areas of concern, rather than a specific distance filter. This was because there was a lack of consistent evidence about the appropriate starting distance of any filtering analysis.

relatively low cost, especially if only diesel storage tanks are installed and these are placed above ground. This is because there are less regulatory barriers to store diesel compared to petrol.

371.3. Even for local customers, rival truck operators compete for customer accounts by offering discounts off a pump price, or in some cases a list price.

371.4. Depending on the size of the vehicle, some local customers may be able to purchase from retail sites in the local area. It is also possible that some local truck stop customers could switch to bulk purchases. That is, organise for a tank to be installed at their home base and refuel their vehicles from there.

372. In addition, there are very few customers that only purchase from one truck stop and suppliers cannot be sure that those customers are confined only to local areas.[240] This is because although Z may be able to see they only purchase from one Z truck stop, it cannot be sure that the customer does not purchase from a rival's truck stop. Further, the local truck stop customers that we canvassed (with the exception of those in Kawerau) did not express any significant concerns with the loss of one supply option in their local area as a result of the merger.

373. However, one local area remained of concern to us following the analysis. Kawerau is a location where only Z and Chevron currently operate truck stops. Kawerau is relatively geographically isolated and the site services a high proportion of customers who operate only in that area. The proposed merger would reduce the number of truck stop operators in Kawerau from two to one. However, as discussed in the divestment section later, Z offered a divestment that remedied those concerns.

The supply of marine fuel

374. This section deals with the impact of the proposed merger on the supply of marine fuel.

Background

375. All marine fuel supplied in New Zealand is produced at the refinery. The total volume of marine fuel produced at the refinery exceeds demand in New Zealand, so large volumes are exported. However, fuel firms prefer to sell marine fuel domestically because it avoids the additional costs associated with exporting.

How the proposed merger could substantially lessen competition

376. Marine fuel markets are best characterised as bidding markets, where customers use competitive tender processes to obtain competitive prices. We focused on the unilateral effects that could result from the proposed merger removing a competitor that otherwise provides a competitive constraint on Z such that, post-merger, Z would be able to profitably increase prices and/or lower quality.

[240] For example, data that Z provided to us suggested there only around [ ]% of its customers purchase from one truck stop. E-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission 12 November 2015.

377. We do not consider that the proposed merger is likely to raise coordination issues in the supply of marine fuel. This is because:

377.1. customers have the ability to use competitive bidding processes;

377.2. fuel firms cannot readily observe rivals' prices; and

377.3. Chevron is a relatively small participant in the supply of marine fuel whose absence is unlikely to alter any incentive or ability of the remaining major fuel firms to coordinate.

Market definition

378. We defined separate, port-specific, geographic markets for the supply of marine fuel. Although there are different types of marine fuel grades, the type of marine fuel supplied at any given seaport is that which is demanded by the buyers at that seaport. There is only one such type of fuel by seaport so there is no need to further delineate markets.

379. We considered whether there are, but did not define, separate customer markets based on different customer requirements. This is because the competitive dynamics facing different customers are the same.

Competition analysis

380. Z submitted that Chevron does not currently represent a significant competitive constraint in the supply of marine fuel and that the market would be unaffected by the proposed merger.[241] Z further submitted that BP and Mobil have access to sufficient product and distribution infrastructure to expand their supply of marine fuel in a way that would constrain Z post-merger.[242]

381. In all marine fuel markets, we consider that the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition. This is largely because Chevron is not a significant competitor in the supply of marine fuel, and BP and Mobil would remain as competitors to the merged entity. Typically, fuel firms have higher market shares at those ports at which they own storage infrastructure. Chevron does not own any marine fuel storage infrastructure. Chevron only has two regular customers: [ ] and COLL. All other sales are made on the spot market.

381.1. In two marine fuel markets (Auckland and Wellington), Chevron supplies no marine fuel, such that the proposed merger results in no aggregation.

381.2. In three marine fuel markets (Mt Maunganui, Lyttelton and Timaru), Chevron only makes ad hoc spot sales and has low shares of sales by port (between

241 Clearance Application from Z (30 June 2015) at [3.2(b)] and [159].
242 Ibid at [159].

[ ]% and [ ]%). We consider that these low proportions of sales are in part due to the fact that Chevron does not own any marine fuel terminals.[243]

381.3. Chevron is most active in the supply of marine fuel at Marsden Point, where the storage infrastructure is owned by the refinery rather than any individual fuel firm. At Marsden Point, Chevron has a market share of around [ ]% because it holds the term contract to supply COLL's coastal vessel.[244] COLL regularly tenders this contract and expressed no concern about the proposed merger.[245]

381.4. In Nelson and Dunedin, Chevron regularly supplies a single customer ([ ]) with marine fuel on a spot basis, but there is no evidence of Chevron competing for the business of other large customers at those ports.[246] As such, Chevron has a low share of sales in these ports ([ ]% and [ ]%, respectively).

381.5. In all marine fuel markets, BP and Mobil would remain as alternatives to Z post-merger. BP and Mobil would be at least as equally well-placed as Chevron to compete for customers at the various ports and have the same ability to increase supply to any of Z's customers.

382. Only one party ([ ]) raised concerns about the impact of the proposed merger on the supply of marine fuel.
[
]247

382.1. [ ]

382.2. [

]248 249

243 Chevron advised that it has no plans to invest in marine infrastructure. Commerce Commission interview with Chevron (23 September 2015).

244 This is the only term contract held by Chevron. In the last five years, Chevron has not bid for, or held, any other term contracts for the supply of marine fuel. In contrast, Z, BP and Mobil have each bid for a number of other contracts over this period. Chevron advised that it had not had the opportunity to bid for any other contracts.

245 Commerce Commission interview with COLL (16 October 2015).

246 [

]

247 [ ]

248 [

382.3. [

]

383. Having considered these concerns, we are of the view that the removal of Chevron would not constitute a substantial lessening of competition in the supply of marine fuel because the proposed merger would not alter any existing degree of market power held by Z.
[

]

The proposed divestment

384. As set out in our Divestment Guidelines,[250] where we consider that a proposed acquisition is likely to result in a substantial lessening of competition in a relevant market, we consider whether an applicant's proposed divestment undertaking would remedy the identified competition concerns. To do this we assess the composition, asset and purchaser risks associated with the divestment proposal.

385. We consider whether or not the assets of the divestment package will deteriorate prior to the completion of the divestment, whether a purchaser acceptable to us is likely to be available, and whether the composition of the divestment package is sufficient to ensure that the divestment business will be a viable and competitive entity.

386. Z is proposing to divest 19 retail sites and one truck stop. A table of divestment businesses are listed in Schedule 1 of the undertaking (see Attachment A).

Asset risks

387. Asset risk is the risk that the competitiveness of a divested business will deteriorate prior to completion of the divestment.

388. Under the undertaking:

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[

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250 Commerce Commission, *Mergers and Acquisitions Guidelines*, Attachment F, July 2013.

388.1. Z undertakes to preserve the reputation, goodwill and economic viability of the divestment businesses and to hold separate [ ][251] from the businesses it is retaining;

388.2. until the end of the divestment period, Z will appoint PricewaterhouseCoopers, as a Divestment Manager to maintain the ongoing performance, value and viability of the hold-separate businesses; and

388.3. Z has undertaken to divest the businesses within [ ] of acquiring Chevron.

389. We consider that there is little risk of asset deterioration prior to divestment.

Composition risks

390. Composition risk is the risk that a divestment proposal may be too limited in scope, or not appropriately configured, to attract either a suitable purchaser or to allow a successful business to be operated in competition with the merged entity.

391. We consider that the divestments would result in the owner of the site holding the key assets necessary to operate a retail site or a truck stop independently of Z.

392. [ ][252]

393. [ ]:[253]

393.1. [ ]; and

393.2. [ ].[254]

394. [ ]:[255]

394.1. [ ];

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251 [ ]

252 Divestments paper attached to e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (17 April 2016) at [15].

253 Ibid at [4.2].

254 [ ]

255 Divestments paper attached to e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (17 April 2016) at [4.3].

394.2. [
]; and

394.3. [ ].

395. [ ]:[256]

395.1. [
]; and

395.2. [ ].

396. We consider that the scope of the undertaking is such that it is likely to enable the purchaser to effectively compete with Z in the relevant retail and truck stop markets. We do not consider that the proposed divestment presents any significant level of composition risk.

Purchaser risks

397. In assessing purchaser risk, the key factors we consider are:

397.1. whether there will be a purchaser that is acceptable to us ; and

397.2. whether the applicant has an incentive to sell to a party who would not be a strong competitor.

398. A buyer acceptable to us needs to have certain attributes that enable it to be an effective competitor in the relevant market. Examples of attributes that may make a buyer acceptable are:

398.1. it is independent of the merged entity;

398.2. it possesses or has access to the necessary expertise, experience and resources to be an effective long term competitor in the market; and

398.3. the acquisition of the divested shares or assets by the proposed buyer does not raise competition concerns.

399. In support of Z's proposed potential purchasers of the divestment assets, Z submitted that "in principle, all existing participants in the retail supply of petrol and diesel that are independent[257] of Z and Chevron (as set out in Schedule 1 of the

[256] Ibid at [4.4].
[257] Independent of Z and Chevron at the wholesale and the retail level.

undertaking) would constitute competitively effective brands and fuel suppliers for the divestment sites. All of these companies are involved in retail sites and truck stops and there is no reason they would not offer a viable competitive constraint on Z following the transaction".[258]

Is a purchaser acceptable to us likely to be available?

400. We consider that any purchaser risk is reduced as we have already identified potential independent purchasers for each area, [ ]. Any other proposed purchaser must be approved by us in accordance with the terms of the undertaking.

401. We consider that any of the approved purchasers would have the necessary skills, experience and resources to be an effective competitor in the relevant retail markets and that Z would be able to complete the transactions within the divestment period.

402. In addition,
[
].[259]

403. We consider that the level of purchaser risk identified is not sufficient to outweigh our conclusion that the undertaking is likely to remedy the competition concerns in the relevant retail and truck stop markets.

Conclusion

404. Having considered the proposed divestments, we consider that the divestments are likely to remedy the competition concerns identified in respect of retail and truck stop sites.

[258] Divestments paper attached to e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (17 April 2016) at [23].

[259] Ibid at [27].

Determination on notice of clearance

405. Pursuant to s 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Z Energy Limited to acquire 100% of the shares in Chevron New Zealand subject to the divestment undertaking dated 28 April 2016 provided by Z Energy Limited under section 69A of the Commerce Act 1986.

406. Dr Jill Walker has dissented from the decision and her dissenting opinion follows.

Dated this 29th day of April 2016

_____

Dr Mark Berry
Chairman

Attachment A: Divestment undertaking

Z ENERGY DIVESTMENT UNDERTAKING

DEED

GIVEN BY Z ENERGY LIMITED **(Z)**

IN FAVOUR OF NEW ZEALAND COMMERCE COMMISSION ***(Commission)***

BACKGROUND

A On 30 June 2015, Z gave notice to the Commission pursuant to section 66(1) of the Commerce Act 1986 seeking clearance for the acquisition of 100% of the shares in Chevron New Zealand ***(Chevron, Transaction).***

B Z offers the Commission a divestment undertaking in the form of this deed pursuant to section 69A of the Commerce Act 1986.

Divestment undertaking

1 Z undertakes to the Commission that, if the Transaction completes, Z will carry out the Divestments within the Divestment Period ***(Undertaking).***

2 Z acknowledges that the Undertaking;

2.1 forms part of any clearance given by the Commission for the Transaction under section 66(3)(a) of the Commerce Act 1986; and

2.2 imposes legal obligations on Z under the Commerce Act 1986.

Commencement and term

3 The Undertaking comes into effect when it is signed by Z and accepted by the Commission under section 69A of the Commerce Act 1986 (except as provided in clauses 6 and 25).

4 The Undertaking expires on completion of all of the Divestments (except as provided in clauses 6 and 25).

Definitions

5 In this undertaking:

5.1 [
];

5.2 the ***Areas*** means the areas described as such in Schedule 1;

5.3 ***Caltex Divestment Businesses*** [ ];

5.4 ***Distributor Divestment Businesses*** [ ];

5.5 ***Divestment Businesses***
[ ];

5.6 the ***Divestment Manager*** means the person appointed pursuant to clause 13;

5.7 the ***Divestment Period*** means [ ] from the date the Transaction completes;

5.8 the ***Divestments*** means completion of transactions that entail the unreserved divestment of all of Z's assets. Including:

(a) any physical assets;

(b) any contractual arrangements, by way of typical provisions for the assignment or novation of contracts;

(c) any licenses and consents; and

(d) any other assets and undertakings;

[

]

5.9 ***Purchaser*** means [ ];

5.10 [ ]; and

5.11 ***Z Retailers*** means the Individuals contracted by Z to operate retail service stations.

Conduct during the Divestment Period
Expiry

6 Clauses 7 to 18 come into effect at the beginning of the Divestment Period and (as applicable) expire for each of the Divestment Businesses on completion of the Divestment in its Area. For the avoidance of doubt:

6.1 clause 8.1 expires only when Divestments have been completed in [ ];

6.2 clause 8.2 expires only when the Divestment in [ ] has been completed.

Preservation obligations

7 In relation to the [ ]:

7.1 Z will use all reasonable endeavours to:

(a) preserve their reputation and goodwill;

(b) preserve their economic viability, marketability and competitiveness;

(c) maintain their provision of goods and services in a manner consistent with the provision of goods and services as at the date of the Undertaking;

(d) encourage Z Retailers to remain with the Divestment Businesses (where relevant); and

(e) in the case of [ ],

7.2 Z will not carry out any act upon its own authority that might have a significant adverse impact on the value, management or competitiveness of the [ ] or that might alter the nature and scope of activity, or the industrial or commercial strategy, of the [ ].

8 [ ];

8.1 [ ];

8.2 [ ]; or

8.3 [ ]
.

9 [ ]:

9.1 [ ];

9.2 [ ];

9.3 [
]; and

9.4 [
].

10 [
]

Non-solicitation obligations

11 *Z* undertakes that, subject to legal limitations, it will not solicit the owners or any staff of the [ ].

Hold-separate obligations

12 Clauses 13 to 17 will apply to [ ] ***(Hold-separate Businesses).***

13 Z will appoint as a Divestment Manager the firm PricewaterhouseCoopers.

14 Z will procure that the Divestment Manager use all reasonable endeavours to maintain the ongoing performance, value and viability of the Hold-separate Businesses in accordance with Schedule 3.

15 Z will procure that the Divestment Manager be responsible for setting the [ ], in accordance with Schedule 3.

16 Z will procure that the Divestment Manager report directly to Z's board of directors (with this function delegable to the chairman and, for day to day matters, to the company secretary). Should Z receive any information regarding wholesale or retail fuel pricing or fuel sales volumes at the individual Hold-separate Businesses through the reporting process, the information will be subject to clause 17.

Ring-fencing obligations

17 *Z* will:

17.1 ensure that any information it receives regarding wholesale or retail fuel pricing or fuel sales volumes at individual Hold-separate Businesses is used only for the purposes of:

(a) carrying out operational and administrative functions;

(b) assessing the performance of the Hold-separate Businesses;

(c) progressing the Divestments;

(d) reporting to the Commission pursuant to clauses 23 and 24; and

(e) complying with legal and regulatory obligations (including obligations relating to taxation, accounting, financial reporting or stock exchange disclosure requirements); and

17.2 ensure that neither the Hold-separate Businesses nor the individuals within PricewaterhouseCoopers who carry out the role of Divestment Manager obtain any commercially sensitive information relating to fuel sales prices or volumes at other Z-supplied retail sites.

18 Z will procure that all members of Z's staff (including independent contractors) who might receive any information regarding fuel pricing or fuel sales volumes at individual Hold-separate Businesses sign a confidentiality undertaking pursuant to which they undertake not to access or use such information except for the purposes set out in clause 17.1.

Purchaser approval

19 Clauses 20 to 22 apply in relation to all assets to be divested in [ ] and, for all other Divestments, if and to the extent Z proposes to divest any of the assets of the Divestment Businesses (other than the fuel supply agreement) to a purchaser [ ].

20 Z will notify the Commission at least 20 business days before the end of the Divestment Period of the identity of the proposed purchaser.

21 Z must demonstrate to the Commission that the Divestment will be carried out in a manner consistent with the Undertaking and that the proposed purchaser of the assets:

21.1 is not associated with, or an interconnected body corporate of, Z or any of its interconnected bodies corporate;

21.2 has the financial resources, expertise and incentive to operate the relevant aspects of the Divestment Business as a viable competitor; and

21.3 is not likely to create competition concerns that would result in a contravention of section 47(1) of the Commerce Act 1986.

22 Z will ensure that final binding agreements effecting the Divestments are conditional on obtaining the Commission's approval of the proposed purchaser based on the criteria set out in clauses 20 and 21.

Monitoring compliance with the Undertaking

23 Z will, at the Commission's request, provide to the Commission any information and documents reasonably required:

23.1 about the Divestments and Z's progress towards carrying out the Divestments; and

23.2 demonstrating that Z's conduct during the Divestment Period complies with the Undertaking.

24 Without limiting clause 23, Z will provide to the Commission:

24.1 The terms of engagement between Z and the Divestment Manager at least 5 business days prior to the commencement of the Divestment Period.

24.2 [
].

24.3 A copy of all transaction documents relating to each of the Divestments within one business day of their execution.

24.4 Notification of the completion of each Divestment, within one business day of its completion.

25 Clause 26 comes into effect at the beginning of the Divestment Period and expires for [ ] on completion of the Divestment in its Area.

26 Z will procure that the Divestment Manager provide monthly reports to the Commission comprising:

26.1 [ ]; and

26.2 [
].

27 Nothing in the Undertaking requires Z to provide legally privileged information or documents.

SCHEDULE 1 - TABLE OF DIVESTMENT BUSINESSES AND APPROVED PURCHASERS

Area	**Z Divestment Businesses**	**Caltex Divestment Businesses**	**Distributor Divestment Businesses**	**[ ]**
Addington, Christchurch	Z Addington	Caltex Lincoln Road	-	[• •]
Darfield	Z Darfield	-	Challenge Darfield	[ ]
Epsom, Auckland	Z Epsom	Caltex Epsom, Caltex Capricorn and Caltex Newmarket	-	[ ]
Lower Hutt, Wellington	Z Hutt Road	Caltex Railway Avenue	-	[ ]
Kaiapoi	Z Kaiapoi	Caltex Kaiapoi	-	[ ]
Kaikohe	Z Kaikohe	Caltex Nga Puhi	-	[ ]
Kaitaia	Z Kaitaia	Caltex Kaitaia	-	[ ]
Matamata	Z Matamata	Caltex Matamata	Challenge Matamata	[ ]
Milton	Z Milton	Caltex Milton	-	[ ]
Motueka	Z Bowater Motors	Caltex Motueka	-	[ ]
Opotiki	Z Opotiki	Caltex Opotiki, Caltex Bridge Street	-	[ ]
Paihia	Z Paihia	Caltex Waitangi	-	[ ]
Picton	Z Picton	-	Challenge Picton	[ ]
Putaruru	Z Putaruru	-	Challenge	[ ]

Area	**Z Divestment Businesses**	**Caltex Divestment Businesses**	**Distributor Divestment Businesses**	**[ ]**
			Putaruru	
Rangiora	Z Rangiora	Caltex Rangiora	-	[ ]
Riccarton, Christchurch	Z Riccarton	Caltex Riccarton	-	[ ]
Te Aroha	Z Te Aroha	Caltex McConnochies	-	[ ]
Twizel	Z Twizel	-	McKeown Twizel	[ ]
Yaldhurst, Christchurch	Z Yaldhurst	Caltex Russley	-	[ ]
Kawerau	Z Kawerau Truck Stop	Caltex Kawerau Diesel Stop, Caltex Kawerau Onepu Mill Dieselstop	-	[ ]

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2.

2.1

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2.3

2.4

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4.3

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4.5

5.]

[

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2.

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4.1

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Dissenting opinion of Dr Jill Walker

1. For the reasons given by Dr Mark Berry, Sue Begg and Anna Rawlings (the majority), I am satisfied that Z's acquisition of Chevron will not have, or would not be likely to have, the effect of substantially lessening competition in the markets for the supply of: terminal storage facilities; bitumen; aviation fuel; petroleum products to commercial customers; diesel to commercial customers at truck stops; and marine fuel. I am also satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition due to unilateral effects for the supply of fuel to retail customers through service stations since the proposed divestments address areas of concern.

2. However, unlike the majority, I am not satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition due to coordinated effects in the supply of fuel to retail customers through service stations.

3. Retail fuel markets are characterised by a relatively homogeneous core product making firm level demand more elastic. However, market demand is inelastic. These features mean that coordinated effects are potentially more significant than unilateral effects. Firms are likely to find it profitable to jointly raise prices, whereas their ability to unilaterally raise prices may be limited by the homogeneity of their core product.

4. I consider that the features of retail fuel markets are conducive to such coordination and that the evidence is consistent with a level of pre-existing coordination. In my view, the proposed merger would be likely to entrench that coordination and see coordination occurring more completely and more quickly than it does presently. Even small delays in a price change can result in significant savings for consumers and, as such, I am not satisfied that future competition would not be substantially lessened.

5. Moreover, even though Chevron may not be a particularly disruptive force at present, there is an option value in preserving Chevron's assets independent of the other major fuel firms. Fuel markets in New Zealand are already concentrated and unlikely to see entry on the scale displayed by Z (previously Shell), Chevron, BP and Mobil. Entry and expansion by Gull, a retailer with its own supply chain, has introduced a degree of valuable competition in certain markets but we are unlikely to see this competition introduced to many, if any, retail markets in the Wellington region or the South Island. This merger further concentrates the relevant markets by reducing the number of major vertically integrated participants from four to three in those locations and so raises concerns about how competition may play out in the future with the merger as compared to the future without the merger. Maintaining Chevron's independence would maintain the prospect of increased competition from Chevron in the future, a prospect which is removed by the merger.

Competition assessment – coordinated effects

6. In markets where firms cannot price too differently because products are very similar so customers typically choose the lower priced offer (firm level demand is

elastic), a price increase may only be effected if all the firms in a local market raise their prices at the same time.[260] Sometimes this happens when all firms experience the same cost increase. In a competitive market economic profits would remain the same because the new price only reflects this cost increase.

7. However, when firms can easily observe prices, then they can learn through regular interaction[261] in the market how their competitors behave. By moving their prices together firms do not gain from winning customers from each other but rather from the higher prices that they charge to their share of customers. If firms learn that following or 'accommodating' their competitors price increase (even where this is not justified by a cost increase) is more profitable than maintaining a lower price and winning customers for the short period where there is a price differential,[262] then this 'learning by doing' can result in a 'leader-follower' pricing pattern.

8. This 'tacit coordination' arises from mutual yet independent recognition that firms can benefit from competing less aggressively with one another. It is profitable for each firm because of each firm's accommodating reactions to the conduct of the others and does not involve any explicit agreement. The strategy only works if sufficient firms in a market follow the leader. The result is higher profits than would be earned under a more competitive outcome.

9. A competitive price increase can be told apart from a coordinated price increase by whether margins increase. If one firm raises its prices more than the input cost changes (absent any change in their demand) or if prices decrease by less than the reduction in costs, then margins increase.

10. In my view, there is currently evidence of such tacit coordination among petrol retailers which follows a leader-follower pattern. The result is prices that are above what they would otherwise be if more effective competition were taking place. In my view, the evidence from retail fuel markets in New Zealand suggests that tacit coordination has contributed to increased fuel firm margins.

Have margins increased?

11. The evidence shows that industry margins and those of individual competitors have approximately doubled since Z purchased Shell in 2010,[263] in line with Z's publicly stated strategy.[264]

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260 This will be tempered to the extent of product and geographic differentiation.

261 This 'regular interaction' can be as simple as observing how their competitors price and how much custom is lost to a lower priced competitor.

262 This gain is temporary because rivals would soon follow the price cut in order to regain lost sales.

263 See http://www.mbie.govt.nz/info-services/sectors-industries/energy/liquid-fuel-market/weekly-oil-price-monitoring. Data provided by the vertically integrated fuel firms shows that [ ].

264 [ ] (July 2011) provided by Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2016) and "Z Energy Investment Statement and Prospectus" (25 July 2013) provided by Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2016).

12. Z's strategic documents and public statements following its purchase of Shell in 2010 indicate that it sought to manage margins up. Although Z has made investments to improve quality, I do not consider Z to have offered an adequate explanation for those margin increases, nor am I satisfied that the possible alternative causes of the increased margin can fully explain it. This leaves coordination as a likely cause for at least some of that margin increase.

    12.1. Margin increases cannot be explained by increases in demand. If there was an outward shift in demand we could expect margins to increase. However, according to Table 5 of the majority reasons and the views of Z, demand has been essentially flat.[265]

    12.2. Margin increases cannot be explained by increases in differentiation. If there was an increase in differentiation then we may, depending on the dispersion of competitors and the closeness of competition, expect margins to increase.[266] However, there has not been a material increase in differentiation following Z's investment since BP was already positioned as a premium offer. Rather, Z has repositioned its offer along the quality spectrum. Further, Z's internal documents suggest that price is a key driver of consumer preference in fuel, although some consumers would pay somewhat more for quality, limiting the return on differentiation.[267]

    12.3. Margin increases are not fully explained by increases in retail asset investment. Z has invested to reposition the Shell sites to a better quality offering. If customers value Z's improved retail offering then we could expect consumers to be willing to pay more for Z's fuel and Z's retail margins could increase. However, Z's increase in retail margins has occurred at both the gross and EBIT level and [ ].[268] Z's margins continue to increase even though most service stations appear to have had one major upgrade to reposition as a higher quality station rather than significant ongoing quality improvements in service stations.[269] In addition, [

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265 Commerce Commission interview with Z (23 March 2016) ("…the total number of litres sold in the market is flat.").

266 Under this explanation, fuel firms may compete less closely with each other along the spectrum of service quality and therefore all would be able to raise prices since competition may be weaker. In particular, Z's movement away from Mobil and Caltex along the service quality spectrum towards BP leaves Gull and independent sites as the main competitors to Caltex and Mobil, while Z competes more closely with BP on a like-for-like basis. However, this change in quality offering by Z could rather have intensified competition faced by BP. Moreover, competition at the lower quality end of the spectrum can also filter through to pricing at the higher end.

267 Z's internal documents note that [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015).)

268 See for example: Submission from Chapman Tripp (on behalf of Z) to the Commerce Commission (12 March 2016) at 13.

269 See for example [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015) at 9-10.

].[270] [271]

13. The increase in margins instead appears to have come about from Z's different strategy from Shell. Z has told us that Shell focused on generating volumes of sales and led prices down.[272] Z has shifted to a strategy focused on increased margins at the expense of volume.[273] This shift to a price before volume strategy is consistent with market participants seeking a coordinated outcome.[274] This plays out through the leader-follower pricing pattern observed in these markets.

14. The differences in costs are not large (see the majority reasons at [219]), while price differences can be as large as 30cpl between sites.[275] Z remains profitable while pricing these sites well below MPP, which underscores that there could be significant unexplained margin.

Are these markets vulnerable to coordination?

15. Retail fuel markets are typically recognised as being vulnerable to coordination.[276] New Zealand retail fuel markets are no exception. In my view the characteristics of retail fuel markets in New Zealand strongly support coordination. Although there may be a factor that does not fully lend itself to coordination,[277] in the round these factors are conducive to coordination. As discussed further below, in my view the evidence is also consistent with coordination actually occurring. The various factors are discussed in more detail in the majority reasons and include the following.

    15.1. A homogeneous core product which allows fuel firms to more easily reach agreement as fewer product features need to be defined in a collusive agreement. There is some differentiation in service offering which allows higher quality sites, such as the Z and BP sites with 'hotel quality' restrooms

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[270] [ ]

[271] It is also worth noting that coordination is not inconsistent with firms investing to re-position their product offering where it is profitable to do so because enough people are prepared to pay for the improved offer.

[272] Commerce Commission interview with Z (23 November 2015).

[273] [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (6 November 2015) at 4.

[274] Kovacic, W.E., Marshall, R.C., Marx, L.M., and White, H.L. (2011), "Plus factors and agreement in antitrust law", *Michigan Law Review* 110(3) 393 at 422. ("In an industry where the product made by different firms is largely homogeneous, a shift in perceptions of sales forces across firms in an industry to 'price before volume' leads to the strong inference of explicit collusion.")

[275] Evidence includes, but is not limited to, submission from AA to the Commerce Commission (9 September 2015 at 7. [.]

[276] See for example the OECD's "Policy Roundtables: Competition in road fuel" (2013) which notes that "Market conditions in the retail gasoline markets, such as high transparency, an essentially homogeneous product, a stable and inelastic demand, and extensive vertical relations, often favour coordination".

[277] For example, there are some asymmetries in costs. While these asymmetries are not atypical in markets where coordinated outcomes are evident (it is seldom that firms have identical costs) it is useful to note that asymmetries can both make coordination more difficult in that a firm with lower costs may have more incentive to cheat, but asymmetries may also support punishment in that a lower cost firm may have a greater ability to punish.

and barista coffee, to charge a premium over lower quality sites such as unmanned stations in markets where customers value this extra service.[278] However, as leader-follower coordination means that fuel firms follow price changes, this premium is maintained and so does not need to be readjusted when prices change. To illustrate, if a Z station can maintain a 4cpl premium over a lower tier Mobil station, because sufficient customers would not switch away given that price difference, this does not make price following more difficult. If Z leads a price increase of 2cpl and Mobil follows by adding 2cpl to its own price then the Z premium is maintained.[279] That is, the premium for service differentiation only needs to be established once, not every time the price changes.

15.2. A concentrated market which makes reaching and monitoring agreement easier. Each local retail fuel markets has one or more of the four vertically integrated fuel company sites, independently owned but industry supplied brands and Gull. That is, independents and/or Gull may be present in a local market but there would not be a multitude of different offers within 2km.[280] Even where there are an array of smaller companies present in a market, coordination among a subset of players is possible so long as those players have market power.[281] In this case some independents have been identified to play a disruptive role, such as Gull, while others are part of the coordination in that they also follow price changes.[282] There are many markets where coordination has been successful despite independent players being present.[283]

15.3. Small and frequent purchases limit the loss that a firm makes if its competitors deviate, as well as the gains from deviation, and facilitates the firms learning from each other's behaviour over time.

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278 The extent to which petrol retailers can charge a premium for their fuel will depend on the willingness of consumers to unbundle their fuel purchase from other convenience products.

279 Fuel service stations are largely vertically rather than horizontally differentiated. In many horizontally differentiated markets customer preferences vary so that there is no clear ranking of products for which consumers might be willing to pay more. However, in retail fuel markets there is a relatively clear ranking of fuel sites (vertical differentiation) in terms of higher to lower quality. That is, most if not all consumers would be willing to pay more for a full-service station rather than an unmanned one). This makes the premium for higher quality sites easier to establish and so coordinating on price is easier. (See for example Motta, M. 2004. *Competition policy: theory and practice*. Cambridge University Press at 77).

280 A 2km radius has been used as a rough designation for geographic markets.

281 For instance, in papers filed in Canada by the Commissioner of Competition in the Competition Tribunal regarding the proposed acquisition by Parklands Industries Ltd of Pioneer Fuel Companies, The Commission's expert, Marcel Boyer, notes that "*It is not uncommon that a dozen gas stations or even more would jointly reach a market share of over 80% and hence find it profitable, because of the joint market share and low elasticity of demand, to engage in coordinated conduct to increase prices*". (Tab B: "A review of the proposed acquisition by Parkland Industries of substantially all retail gazoline assets of Pioneer Companies" at [35]).

282 See for example, Commerce Commission interview with [ ].

283 Coordination does not need to occur between all market participants. Rather, those market participants that do coordinate need to collectively hold market power to influence the market price. Firms can sit outside of the coordinating group if they do not disrupt the coordination, either because they do not undercut the coordinated offer or because they are not effective competitors.

15.4. Transparent board pricing and transparency in off-board pricing[284] allows firms to more easily reach agreement, monitor adherence to an agreement and target punishment at deviators. The MPP published on Z's website further increases pricing transparency. Z's competitors can monitor MPP price changes to quickly and easily identify when Z is adjusting its 'national' price. The MPP therefore provides a useful coordination device or point of reference for price movements. This is regardless of the fact that MPP may have been established for other reasons or the fact that individual retail outlets may have been priced above or below MPP.

16. These features of the market make it easier to reach and maintain an implicit agreement around price movements. In a leader-follower model the three requirements of successful coordination are met through repeated interaction.[285] An 'implicit agreement' is reached through firms observing price changes and following each other. The high level of transparency in the market, homogeneity, and the vertically integrated fuel firms' close monitoring of on-board and off-board pricing[286] enables these firms to observe their rivals' price changes. Firms learn through repeated interaction that following a price increase is individually and collectively more profitable than 'deviating' or maintaining a lower price.[287] 'Punishment', ranging from a price war to a simple price reversion, the latter of which is most commonly observed in the markets studied here, disincentivises competitors from not following the price leader. If sufficient rivals do not follow then all firms in the market revert to charging lower prices and so earn lower profits.[288] [289] Deviation is easy to detect and reversion is easy to observe given the transparency in these retail markets. Firms learn that there is little to be gained from competition.

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284 [ ] Retailers can price discriminate between price sensitive and less price sensitive customers through these discounts off the board. For those customers that do not use rewards the board price applies. Discounts are given off the board and so any softening of competition would also affect the final price that more price sensitive customers receive. [ ]. Commerce Commission interview with Z (23 March 2016).

285 The three requirements of coordination are the ability to reach, monitor and punish deviation from an "implicit agreement". "Implicit agreement" does not imply a legal agreement but rather a mutual recognition of accommodating responses producing higher profits.

286 Off-board pricing includes loyalty discounts, such as FlyBuys points and shopper dockets.

287 Similarly, following a price decrease that passes through less than a full cost reduction to consumers (and so retaining some of these cost savings as profits) may be more profitable than passing through the full cost reduction and winning consumers from rivals.

288 See for example Harrington, J.E., (2012) "Evaluating mergers for coordinated effects and the role of "parallel accommodating conduct" (The Johns Hopkins University Working Paper No. 601) at 654. ("This pattern of behaviour does not involve any agreement that the merged firm will punish the other two firms if they fail to follow; but all three firms know that the merged firm will likely rescind its price increases in that event … What makes it individually rational to follow the price increase is that … failure to do so will result in the merged firm lowering its price").

289 As first highlighted in Green & Porter (1984), breakdown is not inconsistent with coordination (Green, E.J. and Porter, R.H. (1984) "Noncooperative collusion under imperfect price information", *Econometrica*, 87. Cited in Baker, 2008.). In fact, the breakdown of a collusive arrangement "may even be part of the mechanism by which cheating is deterred during high-price periods." (Baker, J.B. (2008) "Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects under the Antitrust Laws", *Economics of Antitrust Law*. Economic Approaches to Law Series. Eds. Klein, B. and Lerner, A.V. p.470-538. Northampton, MA.)

Are market outcomes consistent with coordination?

17. In my view, the evidence suggests that it is likely that coordination is already occurring.

18. Although I agree with the majority that coordination is less likely to be occurring successfully in areas north of the Wellington region, coordination is seldom perfect. Coordination is often characterised by periods of breakdown and, under the leader-follower model, this breakdown could be a factor teaching the firms not to compete, since exception pockets (where following occurs less frequently) are somewhat less profitable than sites where coordination is occurring more successfully.

19. The evidence shows that industry margins have increased, this increase has been somewhat higher for sites priced closer to MPP compared to sites further below MPP, and that the number of sites that are below MPP has increased. This information collectively suggests that coordination may be occurring everywhere but not as successfully in some areas.

Z's internal documents

20. In my view Z's internal documents provide evidence consistent with a price leader-follower model of coordination.

21. The internal documents suggest that fuel retailers are following each other's price changes rather than competing the price down, leading to higher margins. This behaviour happens more regularly and more successfully in MPP areas. For example, a Z internal e-mail notes that [ ].[290] In its retail reports Z further discusses the regularity of price following, the lag with which some firms follow and exception areas.[291]

22. Z's concerns about whether competitors will follow price increases are almost invariably confined to the exception areas.[292] This does not necessarily mean there is no coordination, but rather that coordination is imperfect. The rise in margins (discussed above) suggests that this following of price changes has not merely been driven by input cost changes or changes in demand.

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290 Z internal e-mail [ ] (document ID: ZEN.100.02245) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2015).

291 For example, Z's [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015).

292 See for example Z internal e-mail [ ] (document ID: ZEN.100.03594) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2015).
[ ]

23. Z's exception areas are most commonly located where Gull is, but also some Waitomo and Mobil sites for instance.[293] However, there is evidence that Z's pricing is sometimes at or close to MPP when Gull is present. Further, there is evidence that [ ]. For example, an internal Z e-mail notes that
[
].[294]

24. The internal documents show that Z monitors its rival's reactions and, when rivals do not act in accordance with the implicit agreement, Z returns its pricing to the previous price level.[295] This pattern of reversion, which is consistent with punishment, can most clearly be seen in exception areas where following is not occurring as frequently.

25. The internal documents further show that Z is seeking to take a leadership role in pricing. Z has made public announcements that it believes margins need to improve and the internal documents show that it normally seeks to be the first mover on prices. For example, a Z performance report notes that
[ ][296] while another strategic document states, for example, that
[ ].[297]

26. This is the case for price decreases as well, where Z seeks to control the degree to which prices fall. For example, a Z internal e-mail argues that
[ ][298] while a retail performance report notes, for example, that
[ ].[299]

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293 See for example Z's internal e-mail [ ] (document ID: ZEN.102.02834) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2015).
[
]

294 Z internal e-mail [ ] (document ID: ZEN.100.00836) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (29 January 2015).

295 See for example Z internal e-mail [ ] (document ID: ZEN.100.01125) provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2015).
[ ]

296 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015) at 1.

297 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (17 October 2015) at 38.

298 Z internal e-mail [ ] (document ID: ZEN.102.00433 provided under cover of a letter from Chapman Tripp (on behalf of Z) to the Commerce Commission (22 January 2015).

299 [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (11 December 2015).

MPP

27. The evidence shows that prices are very similar in some parts of the country (those at MPP) while they can be markedly different in others (in exception areas). As noted, price differences between sites can be as large as 30cpl. Z told us that it reacts to local market conditions, which include consumers' willingness to pay and the aggressiveness of competitors, which may explain the differences in pricing.[300]

28. I accept that the number of Z sites pricing at MPP has fallen. However:

    28.1. Z's margins have increased over the same period which is consistent with Z increasing its MPP price to try to lift margins further while achieving less complete following by more sites pricing below MPP; and

    28.2. almost all of the exception sites remain in areas north of the Wellington region. Z internal documents show that the primary drivers of prices below MPP are Gull and occasionally Mobil. In the Wellington region[301] and the South Island Gull is not present and Mobil does not seem to employ a discounting strategy.[302]

29. I agree with the majority that costs are unlikely to fully explain the difference in prices.[303] Rather, the evidence is consistent with Gull and some other independents acting to disrupt coordination in exception areas.

Entry and expansion

30. I do not anticipate entry or expansion post-merger to compete margins down. The barriers to entry in some local areas are high as investments are lumpy and the market may be saturated such that entry against incumbents may not be profitable.[304] There can also be difficulty in obtaining land consents as well as other sunk cost considerations such as underground tanks and decontamination on the sale of the land.

31. Further, entry on a larger scale with a national network is even less likely since this requires multi-market entry, building a brand, and could entail obtaining access to a distribution network of terminals and storage facilities. Z's documents identify that this type of entry is unlikely.[305]

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300 Commerce Commission interview with Z (23 March 2016).

301 Apart from in Masterton where we do not consider Gull to be applying the same competitive constraint since [ ].

302 Commerce Commission interview with Z (23 March 2016).
[
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303 Majority reasons at [219].

304 See for example, [ ] attached to an e-mail from Chapman Tripp (on behalf of Z) to the Commerce Commission (6 December 2016).

305 Ibid.

32. While it is possible that a fuel firm may expand to an additional local area, I am not satisfied that entry or expansion into the Wellington region and the South Island, if it were to occur, would be likely to disrupt MPP pricing.

    32.1. Expansion by BP is unlikely to allay my concerns as BP does not appear to currently compete vigorously with Z to drive prices below MPP, but rather these fuel firms accommodate each other's price changes.

    32.2. I cannot rely on expansion by discounting Mobil sites to allay my concerns. In markets in the north of the North Island where Gull is also present certain Mobil sites compete vigorously. Z acknowledges that Mobil does not employ this strategy in other parts of the country where pricing is closer to MPP.[306]

    32.3. I cannot rely on expansion by independents supplied by the vertically integrated fuel firms to allay my concerns. There is little evidence that the increase in the number of these independents has undermined the pre-existing level of coordination I observe in the market.[307]

33. Prices remain systematically lower in areas where Gull, along with other competitors, is present. If Gull were to establish sites in the Wellington region[308] or the South Island, this increased competition might lead prices to more closely reflect those in the north of the country.

34. However, I cannot rely on expansion by Gull to allay my concerns. This is because Gull has no plans to expand in the Wellington region or enter the South Island and is hamstrung from doing so by its limited distribution assets and the 'tyranny of distance' from its terminal in Mt Manganui.[309] The majority of Gull's sites are located north of Taupo where fuel can be more economically delivered from its terminal.

35. South Island sites are often rural and volumes tend to be smaller (apart from in Christchurch and smaller centres) which may limit the profits to be made at those locations and so make entry less attractive. Gull has told us that it is 'just too hard' to expand to the South Island. It has considered the case of investing in distribution assets in Timaru and Lyttelton but found it uneconomic to do so since it would need to make significant investments to open an import terminal in the South Island. Further, it could not secure access to distribution assets in the South Island, although it has attempted to do so in the past without success.[310]

The impact of the merger

36. I disagree with the majority that the loss of Chevron is not likely to materially affect coordination. The divestments offered around 22 local retail markets do not satisfy

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306 Commerce Commission interview with Z (23 March 2016).

307 I do note that NPD believes that [ ]. Commerce Commission interview with NPD (3 November 2015).

308 In addition to its Masterton site, discussed at footnote 301.

309 Commerce Commission interview with Gull (4 September 2015).

310 Ibid.

my concerns as there is overlap between the merging parties in approximately 100 local markets.[311] Furthermore, even where there is not currently overlap, in the future without the merger Chevron could potentially expand the footprint of its operations into other local markets, disrupting established coordination.

37. Although I agree that Chevron and the retailers that it supplies do not seem to be significantly disrupting or destabilising current coordination, coordination is imperfect and there remains some uncertainty as to whether Chevron will always follow Z's pricing lead. With the merger, this uncertainty is reduced. Chevron's retail site pricing would be driven by Z's wholesale price, and the price to Caltex sites is determined on a 'retail minus' basis. I cannot exclude the real chance that tacit coordination of retail prices would become more complete and firmly entrenched with the merger.

38. Not only would this mean that the uncertainty about Chevron's retailers is reduced, but remaining retailers would also have increased confidence that a greater proportion of the market would move prices in line with Z, so that price rises are more likely to stick. This may give other retailers greater confidence to follow a Z price change. Certainty that a price change will stick would also increase when Z follows a competitor's price change.

39. Further, Chevron not only follows Z's prices up but also follows Mobil and Gull's prices down, which may have contributed to lower pricing in exception pockets. If Chevron sites no longer follow price decreases, or do so less frequently or with a lag, then some exception sites may move closer to MPP pricing.

40. An independent Chevron also provides an 'option value' for increased competition in the future without the merger. Without the merger, Chevron's assets would remain independent of Z. Importantly, this involves not simply retail assets, but an entire supply chain. Effective competition in retail fuel markets tends to be driven by retailers who are backed by their own independent supply chain, such as Gull in parts of the North Island. There is no current likelihood of equivalent new entry (or expansion by Gull) into those retail markets that seem to be most affected by coordination to replace Chevron's supply chain if the merger proceeds. I am not satisfied that in the future without the merger, there is not a real chance that Chevron's assets could be used to disrupt retail coordination and increase competition. With the merger, any real chance is permanently removed.

41. Even a small delay in raising prices can have a significant impact on total revenue and results in savings for consumers. While the Court of Appeal in *Woolworths* did not equate price increases of a particular level with a substantial lessening of competition, it said that it is "important to recognise that changes in price which might not appear to be particularly large may well reflect the presence or absence of

[311] Out of all sites that Z supplies, there are 100 where there is a Chevron-supplied station within 2km and 171 where there is a Chevron-supplied site within 5km. The Chevron-supplied sites include sites branded Caltex, Challenge and McKeowns.

what, from the point of view of the supermarkets, is substantial competitive constraint".[312]

42. If Chevron were to act in a manner that disrupted or delayed a 2cpl price increase then this could result in a dollar savings for a consumer filling up a 50 litre tank. This figure is substantial when considering that 9.6 million fuel transactions occurred at Z alone for the three months to June 2014.[313] Petrol sales alone, which are almost entirely made to retail customers, amount to over 3 billion litres per annum.[314]

43. The courts have held that if the Commission is in doubt (by which it means the Commission cannot exclude the real chance of a substantial lessening of competition), it should decline to give clearance. I am in doubt in this sense, and therefore I am not satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition, due to coordinated effects for the supply of fuel to retail customers through service stations.

Conclusion

44. In conclusion:

    44.1. the evidence is consistent with coordination currently occurring, albeit that it is more successful and complete in areas priced closer to MPP (primarily Wellington region and the South Island); and

    44.2. I cannot exclude the real chance that the loss of Chevron would further entrench this coordination and would remove the opportunity for those assets to be used to disrupt coordination in the future.

45. I am therefore not satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition due to coordinated effects for the supply of fuel to retail customers through service stations.

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312 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (Court of Appeal) at [191].

313 Z operational data for quarter ended June 2014. Available at: https://z.co.nz/investor-centre/assets/Uploads/Z-Energy-quarterly-operational-data-June-2014-FINAL.pdf.

314 3,034 million total petrol sales in NZ per annum (see Table 1 of the majority reasons).