COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

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Statement of Preliminary Issues

Aon New Zealand / Fire Protection Inspection Services Limited

21 November 2016

Introduction

1. Aon New Zealand (Aon) is proposing to acquire the book of business, assets and certain liabilities of Fire Protection Inspection Services Limited (FPIS).

2. On 8 November 2016, the Commerce Commission registered an application from Aon seeking clearance for the proposed merger.[1]

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

4. This Statement of Preliminary Issues outlines the key competition issues we currently consider to be important in deciding whether or not to grant clearance.[2]

5. We invite interested parties to make comment on the likely competitive effects of the proposed merger. We request that parties who wish to make a submission do so by **2 December 2016**.

The parties

Aon

6. Aon is a leading provider in New Zealand of insurance broking, various risk management services, and associated services (eg, human resources consulting). The Aon division relevant to this merger is known as Aon Group Risk Consulting, whose activities include the inspection of new and existing sprinkler systems and the inspection and certification of fire alarm systems.

7. In its capacity as Sprinkler System Certifier (SSC), Aon is also involved in the certification of sprinkler systems to a New Zealand standard[3] and the approval and listing of sprinkler contractors and inspection companies. Aon is currently the only entity operating as an SSC.

FPIS

8. FPIS provides a range of fire inspection services throughout New Zealand, including the inspection of new and existing fire sprinkler systems, as well as the inspection and

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1 The public version of the application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/925.

2 The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.

3 NZS 4541:2013.

certification of fire alarm systems. These services are largely provided to FPIS's shareholders, the majority of whom supply fire protection systems products and services to their customers.[4]

Our framework

9. Our approach to analysing the competition effects of the proposed merger is based on the principles set out in our Mergers and Acquisitions Guidelines.[5] As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

10. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[6]

11. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[7]

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

    12.1 existing competition – the degree to which existing competitors compete;

    12.2 potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased; and

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

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

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4 FPIS's shareholders include, among others, Tyco New Zealand Limited (trading as Wormald) and Chubb New Zealand.

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

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

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

Preliminary issues

14. We will investigate whether the merger is likely to substantially lessen competition in the relevant markets by assessing the unilateral, vertical and conglomerate effects that may result from the merger. In particular, we will consider:

    14.1 the relevant markets;

    14.2 whether the merged entity would raise prices for inspection services above the prevailing level (unilateral effects); and/or

    14.3 whether the merged entity is likely to engage in conduct that either forecloses rivals or otherwise makes them less able to compete (vertical and conglomerate effects).

Market definition

15. Aon has submitted that the key market potentially affected by the proposed merger is the national market for the inspection of sprinkler and fire alarm systems. Given Aon's role as the only existing SSC, it submitted that the national market for sprinkler system certification services may also be relevant to the consideration of this merger.

16. As part of our investigation, we will consider:

    16.1 whether there are separate product markets for the provision of various fire protection services, including for the inspection of sprinkler and fire alarm systems;

    16.2 whether the product markets identified by Aon are the only relevant affected markets, or whether there may be other affected markets (eg, backflow testing and flow switch testing); and

    16.3 the geographic scope of the relevant markets, including whether there may be national geographic markets or more narrowly defined regional markets (eg, separate markets for the North and South Islands).

Unilateral effects

17. The merger will result in overlap with respect to the provision of inspection services for sprinkler and fire alarm systems.

18. Aon has submitted that the merged entity will be constrained in these markets by:

    18.1 a number of existing providers of sprinkler and fire alarm systems inspection services (Argest Technical Services Limited, Fire System Inspections Limited, Building and Fire Safety Limited and Hudson Fire Inspections Limited);

    18.2 potential competitors; and

    18.3 the countervailing power of customers.

19. We will consider:

    19.1 the level of aggregation that is likely to result from the merger in the affected markets;

    19.2 the closeness of competition between the merging parties and its rivals;

    19.3 the alternatives available to purchasers of inspection services in New Zealand;

    19.4 the barriers to entry or expansion in the affected markets, including the ease of obtaining accreditation under ISO/IEC 17020 and ability of firms to source the required staff; and

    19.5 the countervailing power of customers, and whether this power will be sufficient to constrain the merged entity from profitably increasing prices (including, for instance, by sponsoring entry and/or expansion of providers of inspection services).

Vertical and conglomerate effects

20. A merger between suppliers can result in a substantial lessening in competition due to vertical or conglomerate effects. The proposed merger raises potential vertical and conglomerate effects.

21. A vertical merger is a merger between firms operating at different levels of a supply chain (eg, a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability and/or incentive to foreclose its rivals, including by refusing to deal with competitors completely (total foreclosure), or by raising prices it charges competitors (partial foreclosure). This merger has a vertical dimension, in that it will combine Aon's interests in inspection and sprinkler system certification services with FPIS's interests in inspection services.

22. A conglomerate merger is a merger between firms supplying products that may be complementary. For example, in this merger, the merged entity will be able to supply inspection services for new and existing sprinkler systems, certification of sprinkler systems and inspection services for fire alarms. Such mergers may, in certain situations, increase a merged firm's ability and/or incentive to foreclose competitors by, for example, bundling together complementary products (eg, inspection and certification services), or by refusing to sell these services to customers unless they also buy a second service from it (tying).

23. Aon submitted that while it is currently the sole provider of sprinkler system certification services, and may choose to offer its services in bundles (eg, sprinkler system certification services and inspection services), no vertical or conglomerate issues are likely to result from the merger. Additionally, Aon does not consider that the merger would increase the ability or incentive of the merged entity to engage in any foreclosure conduct. This is because:

    23.1 inspection services are typically provided as stand-alone services;

23.2 the barriers to entry into the provision of sprinkler system certification services are very low, and similar to sprinkler and fire alarm inspection services require ISO/IEC 17020 accreditation;

23.3 the New Zealand standard under which Aon operates precludes it from refusing to provide other inspection companies with access to necessary information to carry out inspection services; and

23.4 Aon will be constrained by the countervailing power of its customers.

Vertical effects

24. In considering whether it could be profitable for the merged entity to foreclose rivals due to vertical effects, we will consider:

24.1 whether the merger would increase the merged entity's ability and incentive to foreclose rivals by, for example, preventing or hindering other inspection companies from obtaining sprinkler system certification services; and

24.2 whether that conduct would be likely to have the effect of substantially lessening competition in a relevant market.

Conglomerate effects

25. In considering whether it could be profitable for the merged entity to foreclose rivals due to conglomerate effects, we will consider:

25.1 whether the merger would increase the merged entity's ability and/or incentive to foreclose competitors, through bundled discounts or by tying together a range of services, such as fire sprinkler inspection and certification services; and

25.2 whether that conduct is likely to have the effect of substantially lessening competition in a relevant market.

Next steps

26. The Commission is currently aiming to make a final decision on whether or not to give clearance to the merger by **23 December 2016**. However, this date may change as the investigation progresses.[8]

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

Making a submission

28. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Aon/FPIS in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **2 December 2016**.

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

29. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. This may be the case if, for example, disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.