

Statement of Preliminary Issues

Volution Group plc and Proven Systems Limited

1 June 2023

Introduction

1. On 19 May 2023, the Commerce Commission registered an application (the Application) from Volution Group plc (Volution) seeking clearance to acquire 100% of the business and assets of Proven Systems Limited (Proven) (the Proposed Acquisition).¹
2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.²
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **15 June 2023**.
5. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The parties

6. Volution is a UK-based company and is the ultimate holding company of Volution Ventilation New Zealand Limited (Volution NZ), a New Zealand incorporated company. Volution NZ is the parent company of Simx Limited. Simx Limited supplies home ventilation systems under the Smart Vent brand. Volution principally supplies these systems through wholesalers and building supplies merchants.³ Volution NZ is also the parent company of Lupin Investments Limited (Lupin), the company incorporated to facilitate the Proposed Acquisition, as purchaser.
7. Proven is a privately-owned New Zealand owned company. It supplies and installs home ventilation systems under the DVS brand. Proven sells its DVS systems direct to consumers.⁴

¹ A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

² The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

³ The Application at [1] and [21].

⁴ The Application at [6] and [21].

8. The parties' business activities overlap in the supply of home ventilation systems. Home ventilation systems reduce the excess damp, moisture-filled air and improve the overall air quality inside a building.⁵
9. With the Proposed Acquisition, Volution would acquire Proven (via Lupin), and would own and operate both the Smart Vent and DVS brands.

Our framework

10. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.⁶ As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
11. 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).⁷ This allows us to assess the degree by which an acquisition might lessen competition.
12. If the lessening of competition as a result of an acquisition is likely to be substantial, we will not give clearance.

Market definition

13. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed 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, as a matter of fact and commercial common sense.⁸
14. Volution submits that the market relevant to our assessment of the Proposed Acquisition is the national market for the manufacture and distribution of home ventilation systems. It submits that this market includes:⁹
 - 14.1 all types of home ventilation systems; and
 - 14.2 the supply of home ventilation systems to all customers (eg, wholesalers, building supplies merchants and residential consumers).
15. We will consider whether this is the appropriate market for assessing the competition effects of the Proposed Acquisition, or whether it might be appropriate to define narrower markets by product type or sales channel. We will also consider if

⁵ The Application at [12].

⁶ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019.

⁷ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁸ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁹ The Application at [11]-[23].

any other markets are relevant to our assessment of the Proposed Acquisition (eg, for the maintenance and servicing of systems,¹⁰ or for the installation of systems).

Without the Proposed Acquisition

16. Volution submits that the relevant counterfactual against which to assess the competition effects from the Proposed Acquisition is the status quo under which Volution and Proven would remain in competition.¹¹
17. We will consider what would likely happen if the Proposed Acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or something other than the status quo.

Preliminary issues

18. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in any relevant markets by assessing whether any horizontal unilateral, coordinated or vertical effects might result from the Proposed Acquisition. The questions that we will be focusing on are:
 - 18.1 unilateral effects: would any loss of competition with the Proposed Acquisition enable the merged entity to profitably raise prices or reduce quality or innovation by itself?¹²
 - 18.2 coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?
 - 18.3 vertical effects: would the Proposed Acquisition give the merged entity the ability and incentive to foreclose rivals?

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

19. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged entity can increase price above the level that would prevail without the merger or acquisition without the profitability of that increase being thwarted by rival firms' competitive responses.¹³

¹⁰ Volution submits that there is a modest after market opportunity with regard to the supply of filters (which should be replaced periodically). However, it submits that this aspect of the market includes supply of generic components so is broadly contested and is therefore not a focus of the Application. See the Application at [11].

¹¹ The Application at [25].

¹² For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation or worsen an element of service or any other element of competition (ie, it could increase quality-adjusted prices).

¹³ Commerce Commission, *Mergers and Acquisitions Guidelines*, above n7 at [3.62].

20. Volution submits that the Proposed Acquisition would not be likely to substantially lessen competition due to unilateral effects. It submits that:¹⁴
- 20.1 a relatively small aggregation in market share would arise from the Proposed Acquisition;
 - 20.2 Volution and Proven are not each other's closest competitors because they operate using different channels to market, and the focus of their current businesses also differs to some degree. The main overlap is in the supply of positive pressure systems with some overlap in heat transfer systems as well, but Volution also supplies other types of systems that Proven does not supply;
 - 20.3 the merged entity would continue to face strong competition from HRV and numerous other existing competitors (and competing technologies);
 - 20.4 there are low barriers to entry and expansion by suppliers; and
 - 20.5 while Volution and Proven have reasonably strong competitive positions in the supply of positive pressure systems, the market is moving away from these systems to heat and energy recovery systems, where other suppliers are market leaders.
21. We will consider:
- 21.1 closeness of competition: the degree of constraint that Volution and Proven impose, or would impose, upon one another. To the extent that any constraint is, or would be, material, we will assess whether competition lost with the Proposed Acquisition could be replaced by rival competitors;
 - 21.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;
 - 21.3 entry and expansion: how easily rivals could enter and/or expand; and
 - 21.4 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

Coordinated effects: would the Proposed Acquisition make coordination more likely?

22. A merger or acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.¹⁵

¹⁴ The Application at 2-3, [19], [21], [26]-[27], [34]-[35], [37] and [40].

¹⁵ Commerce Commission, *Mergers and Acquisitions Guidelines*, above n7 at [3.84].

23. Volution submits that the Proposed Acquisition would not be likely to substantially lessen competition due to coordinated effects. It submits that the relevant market does not have features that make it prone to coordinated conduct and that the Proposed Acquisition would not change the features of the market in a way that would make coordinated conduct more likely. Volution further submits:¹⁶
- 23.1 the market is fragmented with a long tail of numerous competitors who can expand sales easily, making coordination much more difficult in practice;
 - 23.2 pricing of rivals is not easily observable meaning that it is difficult for competitors to act in ways that promote coordination;
 - 23.3 the products are differentiated with different technologies and solutions being used by different players; and
 - 23.4 the different sales channels utilised by different parties make coordination difficult.
24. We will assess whether any relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in any relevant markets so that coordination is more likely, more complete or more sustainable.

Vertical effects: ability and incentive to foreclose rivals

25. A merger or acquisition between parties who operate in related markets or at different levels of a product's supply chain (eg, a wholesaler and a retailer) can result in a substantial lessening of competition due to vertical effects. This can occur where a merger or acquisition gives the merged entity (or a related entity) a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively (which we refer to as 'foreclosing rivals').¹⁷
26. Volution and Proven operate using different channels to market. Volution principally supplies its Smart Vent home ventilation systems through wholesalers and building supplies merchants, with its systems installed by independent installers. In contrast, Proven supplies and installs its DVS systems direct to consumers.
27. We will consider whether the Proposed Acquisition would give the merged entity the ability and incentive to foreclose rival suppliers from accessing distribution channels and/or independent installers from accessing products, and the likely effect of any foreclosure. Foreclosure of rival suppliers and/or independent installers could occur if the merged entity:
- 27.1 decided it was more profitable for it to sell products currently supplied through wholesalers and building supplies merchants direct to consumers, rather than through wholesalers and building supplies merchants;
 - 27.2 favoured its own (ie, Proven's) installers over independent installers; and/or

¹⁶ The Application at 3 and [52]-[53].

¹⁷ Commerce Commission, *Mergers and Acquisitions Guidelines*, above nError! Bookmark not defined. at [5.1]-[5.5].

- 27.3 sought exclusive supply contracts that restricted or limited competitors' access to wholesalers and building supplies merchants.

Next steps in our investigation

28. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **18 July 2023**. However, this date may change as our investigation progresses.¹⁸ In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
29. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

30. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Volution/Proven" 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 **15 June 2023**.
31. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website. If you make a submission and we do not acknowledge receipt of that submission within two working days, you should resubmit your submission.
32. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in certain circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

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