

## **Determination**

### **Rheem New Zealand Limited and Peter Cocks (2010) Limited [2016] NZCC 2**

**The Commission:** Dr Mark Berry

Sue Begg

Graham Crombie

**Summary of application:** Rheem seeks clearance to acquire the business and assets of Peter Cocks

**Determination:** Under s 66(3)(a) of the Commerce Act 1986, the Commerce Commission gives clearance to the proposed acquisition.

**Date of determination:** 3 February 2016

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## The proposed acquisition

1. On 15 October 2015, the Commerce Commission (the Commission) received an application from Rheem New Zealand Limited (Rheem) under section 66(1) of the Commerce Act 1986 (the Act) seeking clearance to acquire the business and assets of Peter Cocks (2010) Limited (Peter Cocks).

## The decision

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

## Our framework

3. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Merger and Acquisition Guidelines.<sup>1</sup>

## The substantial lessening of competition test

4. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).<sup>2</sup>
5. 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.
6. 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'),<sup>3</sup> or reduce non-price factors such as quality or service below competitive levels.
7. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.
8. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.<sup>4</sup>

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<sup>1</sup> Commerce Commission *Merger and Acquisition Guidelines* (July 2013) <http://www.comcom.govt.nz/business-competition/guidelines-2/mergers-and-acquisitions-guidelines/>

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

<sup>3</sup> Or below competitive levels in a merger between buyers.

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

### When a lessening of competition is substantial

9. 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.<sup>5</sup> Some courts have used the word ‘material’ to describe a lessening of competition that is substantial.<sup>6</sup>
10. 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.

### When a substantial lessening of competition is likely

11. 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.<sup>7</sup>

### The clearance test

12. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.<sup>8</sup> If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.<sup>9</sup>
13. The burden of proof lies with Rheem 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.<sup>10</sup> The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence.<sup>11</sup> 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.<sup>12</sup>

## Key parties

### Overview

14. Rheem and Peter Cocks are each involved in the manufacture and supply of hot water heaters to plumbing merchants and building merchants in New Zealand.

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<sup>5</sup> *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

<sup>6</sup> *Ibid* at [129].

<sup>7</sup> *Woolworths & Ors v Commerce Commission* (HC) above n 5 at [111].

<sup>8</sup> Section 66(3)(a).

<sup>9</sup> In *Commerce Commission v Woolworths Limited* (CA), above n 2 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”.

<sup>10</sup> *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7]. *Commerce Commission v Woolworths Ltd* (CA) above n 2 at [97].

<sup>11</sup> *Commerce Commission v Woolworths Ltd* (CA) above n 2 at [101].

<sup>12</sup> *Brambles New Zealand Ltd v Commerce Commission* above n 4 at [64].

Neither party has a direct supply link to plumbers, or to end customers such as households.<sup>13</sup>

### **Rheem**

15. Rheem, which forms part of the Japanese-based Paloma group of companies, manufactures and supplies a full range of water heaters for distribution throughout New Zealand for both domestic and commercial use. This includes:
  - 15.1 electric hot water cylinders (electric cylinders) both low and mains pressure;
  - 15.2 gas continuous flow water heaters;
  - 15.3 gas storage water heaters;
  - 15.4 electric dairy cylinders (dairy cylinders);
  - 15.5 solar and wetback cylinders; and
  - 15.6 heat pump water heaters.
16. Rheem has a factory in Auckland, where most of its cylinders are made, while the remainder of its water heater products are imported. It also produces tubular electric water heater elements through its Hermetic New Zealand division.
17. Rheem distributes its water heater products nationwide mainly under the Rheem brand through dedicated plumbing merchants and large building merchants.<sup>14</sup>

### **Peter Cocks**

18. Peter Cocks, a privately-owned business, manufactures and supplies the following water heater products mainly for domestic use:
  - 18.1 electric cylinders both low and mains pressure;
  - 18.2 solar and wetback cylinders; and
19. In addition, Peter Cocks manufactures and supplies dairy cylinders.
20. Peter Cocks has a factory in Christchurch where it manufactures low pressure cylinders and finishes main pressure cylinders that are imported from the United Kingdom. It distributes most of its products in the South Island<sup>15</sup> under the Silver

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<sup>13</sup> We have found it is uncommon for a supplier of water heater products to supply directly to a plumber. However, we note for instance that [ ].

<sup>14</sup> Rheem states at 3.5 of its application that [ ]% of its products are sold through large building merchants

<sup>15</sup> At [3.8] of the Application. South Island sales account for [ ]% of Peter Cocks total sales.

Bullet brand. Distribution is mainly through dedicated plumbing merchants and a smaller share through building merchants and solar specialists.<sup>16</sup>

## Other relevant parties

### Competitors

#### *Rinnai*

21. Rinnai, a wholly owned subsidiary of the Japanese-based Rinnai Corporation, is a manufacturer, importer and supplier of hot water heaters. This includes:
  - 21.1 gas continuous flow heaters;
  - 21.2 electric cylinders (low and mains pressure);
  - 21.3 solar and wetback cylinders; and
  - 21.4 dairy cylinders.
22. Rinnai has a factory in Auckland where it manufactures low pressure and mains pressure cylinders. It distributes these products nationwide through plumbing and building merchants with its electric cylinders sold under the Rinnai or HJ Cooper brands.<sup>17</sup> Rinnai has a strong national presence in gas continuous flow heaters which are sold under the Infinity brand. However for electric cylinders, it is stronger in the North Island than the South Island.<sup>18</sup>

#### *Other manufacturers and importers*

23. Other manufacturers of hot water heaters include:
  - 23.1 Superheat Limited (Superheat), a privately owned company with a factory in Christchurch that manufactures electric cylinders (low and mains pressure), solar cylinders and dairy cylinders;
  - 23.2 Sigma Sheetmetal Products Limited (Sigma), a privately owned company with a factory in Auckland, that manufactures and supplies electric cylinders (low and mains pressure), solar cylinders and dairy cylinders;<sup>19</sup>
  - 23.3 Valley Industries Limited (Valley), a privately-owned Dunedin-based company that produces low pressure electric cylinders;
  - 23.4 Dux, a 100% owned subsidiary of the Japanese-based Noritz Corporation, imports mains pressure electric cylinders from Australia, where it is a major manufacturer. It has recently appointed SPK Industries as its new distributor in New Zealand

<sup>16</sup> At [3.11] of the Application.

<sup>17</sup> Rinnai purchased HJ Coopers in 2012.

<sup>18</sup> [ ]

<sup>19</sup> These are mainly marketed under the 'Triumph' brand.

[  
and ];<sup>20</sup>

- 23.5 Robert Bosch (Australia) Pty Limited (Bosch), which forms part of the Bosch group of global companies, imports gas continuous flow heaters and heat pump hot water heaters, that it distributes through plumbing and building merchants.

[  
.<sup>21</sup> ]

*Customers: Plumbing and building merchants*

24. Plumbing merchants are the major sellers of hot water heaters. These include:
- 24.1 Mico and Plumbing World, both of which operate a nationwide network of outlets;
  - 24.2 Chesters, which has stores mainly in the North Island with a smaller presence in the South Island;
  - 24.3 Plumbing Plus, whose members have stores in both the North and South Islands;<sup>22</sup> and
  - 24.4 Oakleys and Reece, which have stores in the South Island and Auckland respectively.
25. In addition, large building merchants, such as Bunnings and Mitre 10, are also involved in the sale of hot water heaters but generally stock a much narrower range of these products.

*Plumbers and gasfitters*

26. The 2,500 to 2,700 plumbers and gasfitters in New Zealand have a major role in influencing the type of water heater products supplied to consumers.<sup>23</sup> Their influence derives in part from the need for hot water heaters to be installed by registered tradespersons as well as being an intermediary between merchants and end consumers.<sup>24</sup>

*Energy Efficiency and Conservation Authority (EECA)*

27. EECA is a Crown Entity established under the Energy Efficiency and Conservation Act 2000 to promote energy efficiency, energy conservation, and renewable energy.<sup>25</sup> It

<sup>20</sup> Interview with Dux, 14 December 2015.

<sup>21</sup> Interview with Bosch, 21 January 2015.

<sup>22</sup> Plumbing Plus is a group of independently owned plumbing merchants that purchase their supplies on a joint basis. See <http://www.plumbingplus.co.nz/>.

<sup>23</sup> Application at [3.5]; Equipment Energy Efficiency Program *Consultation Regulation Impact Statement – Electric Storage Water Heaters*, December 2015 at 18, Rheem Consumer Research November 2014.

<sup>24</sup> Interview with [ ]

<sup>25</sup> <https://www.eeca.govt.nz/about-eeeca/>



is responsible, amongst other things, for regulating energy efficiency standards and labelling for various products and appliances, including electric cylinders. As part of these regulatory functions, EECA sets and implements minimum energy efficiency standards (MEPS) for electric cylinders with which manufacturers and importers of electric cylinders must comply.

## Industry background

### Overview

28. The proposed acquisition relates to hot water heaters. There are two main types of hot water heaters used in New Zealand: electric cylinders,<sup>26</sup> and gas continuous flow heaters.
29. Hot water heaters are used in domestic, commercial and industrial applications. The same types of hot water heaters are generally used across these three areas. However, there is a higher degree of bespoke or custom builds for commercial and industrial projects, particularly in the dairy sector which require open vented large cylinders as opposed to pressurised cylinders.
30. Electric cylinders account for about 60% by volume of the hot water heaters sold annually in New Zealand with gas water heaters accounting for around 30%. The remaining 10% comprises heat pump cylinders, solar cylinders and wetback cylinders. Sales of gas continuous flow heaters have been trending upwards since 2008 while sales of electric cylinders have been steadily decreasing during the same period. A slow decline is predicted in electric cylinder stock from 1.25 million in 2011 to 1 million in 2025.<sup>27</sup>
31. Solar and heat pump units received grants from the government between November 2006 and June 2012.<sup>28</sup> While we have no information on future trends of solar and heat pump cylinders, it has been stated that the sales of solar water heaters and heat pump heaters declined during 2012.<sup>29</sup>

### Electric cylinders

32. Electric cylinders heat water prior to use and store it in an insulated cylinder which is usually housed internally, such as in a hot water cupboard.
33. Traditionally, the most common electric cylinders have been low pressure cylinders, and these remain a common form of water heating in New Zealand, especially in older homes.<sup>30</sup> Low pressure cylinders usually provide hot water at 76 kPa but up to 120 kPa.<sup>31</sup>

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<sup>26</sup> Also referred to as storage water heaters.

<sup>27</sup> *Consultation RIS Electric Storage Water Heaters* at 15, figure 3.

<sup>28</sup> *Ibid* at 11-16.

<sup>29</sup> *Ibid* at 13.

<sup>30</sup> *Consultation RIS Electric Storage Water Heaters* above n 27 at 73.

<sup>31</sup> Low pressure includes 'medium pressure' cylinders, a term some manufacturers use to denote cylinders which have a pressure close to the maximum of 120 kPa.

34. Mains pressure cylinders provide hot water pressurised at mains pressure (ie, above 120 kPa). Mains pressure is considered superior to low pressure. For example, mains pressure cylinders can produce a higher volume of water (ie, more litres/minute), meaning that a domestic shower will be of a better 'quality', and be less likely to be interrupted by another person using water elsewhere in a dwelling. We understand that modern tapware and fittings are designed for mains pressure systems, though some tapware is compatible with all pressure types.<sup>32</sup>
35. The difference in pressure means that plumbers recommend that a person moving from a low pressure cylinder to a mains pressure cylinder will usually need to replace older taps, fittings and tempering valves with ones that are rated for use above 120 kPa. This means a person switching from a low pressure to a mains pressure cylinder will usually incur costs additional to simply replacing the cylinder.  
[ ].<sup>33</sup>
36. Sales of low pressure cylinders have decreased during the past 10 years as they are replaced by mains pressure cylinders or gas continuous flow heaters.<sup>34</sup>  
[ ]<sup>35</sup> Currently, mains pressure cylinders account for the majority of electric cylinders sold in New Zealand. Based on Rheem's estimates, around 61% of electric cylinder sales are mains pressure while the rest are low pressure.<sup>36</sup>

### Gas continuous flow heaters

37. Gas continuous flow heaters heat water only as required and are generally mounted on the exterior of a building. These heaters do not have a cylinder. Rather, they draw on reticulated natural gas (North Island), reticulated LPG (certain parts of the South Island) or bottled LPG gas (North and South Islands). Gas continuous flow heaters provide hot water at mains pressure.
38. The benefits of gas continuous flow heaters over electric cylinders include:
- 38.1 they are generally viewed as a more cost effective way of heating water;
  - 38.2 they heat water continuously (ie, the supply of hot water does not run out); and
  - 38.3 they save on interior space because such heaters are generally mounted on the outside of a house.

### Dairy cylinders

39. Dairy hot water cylinders are a specialist type of gravity fed, open vented cylinder used by dairy farmers for heating water to clean dairy sheds. Dairy hot water

<sup>32</sup> For instance interview with [ ]

<sup>33</sup> Interview with [ ].

<sup>34</sup> Consultation RIS Electric Storage Water Heaters above n 27 at 12 – 13.

<sup>35</sup> Interview with [ ]

<sup>36</sup> Application at [7.5].

cylinders use a variety of heating sources, often in combination, including gas, electricity, and heat exchangers (using waste heat from refrigerating milk).<sup>37</sup>

40. Dairy cylinders are manufactured by Rheem, Peter Cocks, Rinnai, Superheat and Sigma and are sold through dairy shed installers (eg, Waikato Milking and GEA), rural supply companies (eg, RD1 and PGG Wrightson), and to a lesser extent, plumbing merchants.

#### Other hot water heater products

41. The other types of hot water heaters sold in New Zealand account for approximately 10% of sales and include:
- 41.1 wetback cylinders;
  - 41.2 solar cylinders;
  - 41.3 gas storage cylinders; and
  - 41.4 heat pump cylinders.

**Table 1: Estimated NZ unit sales for hot water heaters**

Estimated unit sales New Zealand 2014	Total	% of total
Low and Medium	[ ]	[ ]
Mains Pressure cylinders	[ ]	[ ]
Dairy cylinders	[ ]	[ ]
Solar	[ ]	[ ]
Gas continuous flow and gas storage	[ ]	[ ]
Other (bespoke commercial etc)	[ ]	[ ]
Estimated total units	[ ]	100%

Notes: the above figures are based on data from the following parties: [ ]  
Solar includes mains wetback and heat pump and does not include estimates from specialist solar suppliers.

#### With and without scenarios

42. To assess whether competition is likely to be substantially lessened in any market, we compare the likely state of competition with the acquisition to the likely state of competition without the acquisition.<sup>38</sup>

#### With the acquisition

43. Rheem is proposing to acquire the business and assets of Peter Cocks.

<sup>37</sup> Interview with [ ]

<sup>38</sup> *Mergers and Acquisitions Guidelines* above n 1 at [2.29]; *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

### Without the acquisition

44. Without the acquisition, we consider that it is likely (ie, there is a real chance) that Peter Cocks would continue to operate in the market independently of Rheem, whether under its current ownership or owned by a third-party.<sup>39</sup>

### How the acquisition could substantially lessen competition

45. We consider there are four potential ways in which the acquisition could substantially lessen competition:
- 45.1 unilateral effects could arise by Rheem acquiring Peter Cocks and removing that company as an effective competitor for the supply of mains pressure, low pressure, solar cylinders and dairy cylinders such that the merged entity can profitably increase prices above the competitive level;
  - 45.2 with respect to low pressure cylinders, that manufacturers will be able to price low pressure cylinders up to the point at which customers would switch to mains pressure cylinders or continuous gas flow heaters;
  - 45.3 the strengthening of existing vertical links resulting from Rheem's involvement in the upstream tubular heating element market that could give rise to an increased incentive to hinder its rivals in any downstream market(s) by refusing to supply its elements to rivals (i.e. input foreclosure); and
  - 45.4 coordinated effects that could arise if the proposed acquisition increased the ability of the merged entity and its rivals to coordinate their behaviour post-acquisition.

## Market definition

### Our approach to market definition

46. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.
47. We define markets in the way that 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. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products which fall outside the market but which still impose some degree of competitive constraint on the merged entity.

### The applicant's view of the relevant markets

48. Rheem submitted that the appropriate market to analyse this acquisition is the national market for the supply of hot water heaters to wholesalers.<sup>40</sup>

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<sup>39</sup>[

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### Our view of the relevant markets

49. For the reasons outlined below, we consider that the relevant markets are the national wholesale supply of:
- 49.1 mains pressure electric cylinders, gas continuous flow heaters, wetback cylinders and heat pump cylinders (the **mains pressure market**);
  - 49.2 low pressure electric cylinders (the **low pressure market**);
  - 49.3 solar cylinders; and
  - 49.4 dairy cylinders.

### Product dimension

#### *Mains pressure and low pressure for domestic use*

50. Broadly speaking, domestic customers purchase a hot water heater either when:
- 50.1 they are building a new home or undertaking renovations (we refer to these as **installations**); or
  - 50.2 they need to replace a hot water heater that has broken down, or otherwise reached the end of its useful life (we refer to these as **replacements**).<sup>41</sup>
51. While Rheem has submitted that in both scenarios, customers choose between a range of competing types of hot water heater including, importantly, gas, our investigation has indicated that customers usually only consider a different range of alternatives for installations.<sup>42</sup>
52. For an installation, the main options considered are mains pressure cylinders and continuous gas flow heaters with sales for installations split approximately [ ] between the two.<sup>43</sup> Low pressure cylinders are not generally considered for installations as they provide an inferior output to mains pressure and gas continuous flow heaters. A minority of consumers opt for the more expensive alternatives of solar cylinders or heat pump cylinders.<sup>44</sup>
53. The situation is different for replacements. Suppliers, plumbers and merchants have told us that when a cylinder needs replacing, in the vast majority of cases the cylinder will be replaced as close to ‘like-for-like’ as possible.<sup>45</sup> So, if a consumer has

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<sup>40</sup> Application at [10.2]

<sup>41</sup> *Consultation RIS Electric Storage Water Heaters* above n 27 at 18.

<sup>42</sup> The decision-maker can be either the customer or an architect, with assistance from a plumber: interview with [ ]

<sup>43</sup> [https://www.google.com/url?q=http://www.gasindustry.co.nz/dmsdocument/4646&sa=U&ved=0ahUKEwi48dS4\\_N7JAhXDNJQKHeDCAHYQFggIMAI&client=internal-uds-cse&usg=AFQjCNHfOtFCCdZr--hFdX7\\_7lFqbMMPiw](https://www.google.com/url?q=http://www.gasindustry.co.nz/dmsdocument/4646&sa=U&ved=0ahUKEwi48dS4_N7JAhXDNJQKHeDCAHYQFggIMAI&client=internal-uds-cse&usg=AFQjCNHfOtFCCdZr--hFdX7_7lFqbMMPiw) at slide 8. See also [ ] at slide 15.

<sup>44</sup> Interviews with [ ]

<sup>45</sup> Interviews with [ ]

low pressure they will generally replace with low pressure, mains pressure with mains pressure and so on.

54. This difference between installations and replacements arises because the overriding concern of the customer is to restore their hot water supply as soon as possible, often with as little capital outlay as possible. For example, a person with a low pressure cylinder and taps and fittings to match is not likely to consider replacing the low pressure cylinder with a mains pressure cylinder if that would require them to buy new taps and fittings, which would take time and cost more. This difference between installations and replacements has implications for the product markets we define.
55. While merchants may be aware that some plumbers focus on installations while others are more present in the replacement market, at the point of sale for mains pressure cylinders there is no distinction made between cylinders destined for installation or replacement.<sup>46</sup> As mains cylinders destined for installations compete with gas continuous flow, manufacturers will sell all mains pressure cylinders, including those destined for replacement, at a price and quality that is competitive with a gas continuous flow heater.
56. So, even if a customer is buying a mains pressure cylinder as a like-for-like replacement without considering buying a gas system instead, he or she will benefit from the fact that the manufacturer is likely to be pricing that mains pressure cylinder to compete with gas continuous flow heaters for installations.
57. However, the same is not likely to be true for low pressure cylinders. As already explained, low pressure cylinders are usually purchased for replacement and are not generally considered for installations. In such a situation, a customer will far less frequently consider completely upgrading their cylinder or system to mains or gas continuous flow.
58. Therefore, a manufacturer of low pressure cylinders is likely to know what their cylinder is being used for, and that the majority of customers are likely to only consider other low pressure systems when deciding which hot water cylinder to purchase. It is likely that a monopolist supplier of low pressure cylinders could profitably increase its prices by a small but significant amount without losing sales to other hot water heater products.
59. We note, however, that there are two areas of supply side substitutability between mains pressure cylinders and low pressure cylinders. First, mains pressure cylinders can be installed and operated as low pressure cylinders.<sup>47</sup> If the price of mains

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We were not satisfied as to the precise amount of switching from low pressure in a replacement scenario. Plumbers gave a variety of responses see interviews:

<sup>46</sup> [ ]  
 [ ].  
 [ ] Rheem response to the  
 Commission's letter of issues (10 December 2015).  
<sup>47</sup> Application at [7.3].

pressure remains competitive due to the constraints provided by continuous gas flow heaters, then if the merged party were to raise prices of low pressure cylinders, other manufacturers could respond by selling mains pressure to low pressure customers.

60. Nevertheless, the plumbers we spoke to did not suggest this as an alternative in the event of a price increase of low pressure cylinders. We have therefore proceeded on the conservative basis that there is limited ability for dedicated mains pressure cylinders to be a substitute for low pressure cylinders.
61. Second, there is supply side substitutability between a mains pressure cylinder manufacturer and a low pressure manufacturer in that, for the most part, low pressure cylinders are manufactured using plant and machinery otherwise used for the manufacture of mains pressure cylinders.<sup>48</sup> We consider this supply side substitutability under entry and expansion in the competition analysis.
62. In summary, we have therefore proceeded on the conservative basis of separate low and mains pressure markets. For the purpose of analysing this acquisition, we have also identified a separate market for solar cylinder heaters (see below).

#### *Solar cylinders*

63. Solar cylinders operate by absorbing the sun's energy, for example in collector panels installed on the roof of a house, and that energy is then transferred to the water stored in a cylinder. When there is insufficient energy from the sun to heat the water in the cylinder, it is necessary to have a back-up (usually electric, gas or wetback) to heat the water to the required temperature. The upfront costs of installing a solar hot water system are much higher than other hot water systems but the operating costs can be very economic compared to other types of water heaters.<sup>49</sup>
64. Rheem supplies both the cylinders and solar panels either together or as a packaged solar hot water system while Peter Cocks only supplies cylinders that are solar capable and these need additional fittings and fixtures to make them solar hot water systems. Therefore, the proposed acquisition results in overlap solely in the supply of cylinders that can be connected to solar collector panels as opposed to the complete solar hot water system.
65. Rheem submitted that solar cylinders are substitutable for other hot water heater products from a demand and supply side perspective.<sup>50</sup> [ ] stated that solar together with wetback and heat pump heaters make only a small part of the overall market and, as the vast majority also require a cylinder as a component, these can generally be considered as part of the electric cylinder market.<sup>51</sup>

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<sup>48</sup> Interview with [ ].

<sup>49</sup> See <https://www.energywise.govt.nz/at-home/water/types-of-water-heating-systems/solar-water-heating/>

<sup>50</sup> Application at [10.3.4].

<sup>51</sup> [ ].

66. In discussions with the builders of new homes, we were told that some customers expressed interest in solar as an alternative water heater product for new installations.<sup>52</sup> A plumber specialising in solar water heaters also indicated that solar heaters are mainly used in new installations being considered alongside gas continuous flow and mains pressure alternatives.<sup>53</sup>
67. In theory there could also be a replacement market for solar cylinders similar to that of low pressure and replacement mains pressure. At present, there may not be a replacement market for solar as warranties last for 20 years.<sup>54</sup> However, for the purpose of analysing this acquisition, we have adopted a conservative approach and defined a separate product market for solar cylinders.

#### *Dairy cylinders*

68. On the demand side, mains pressure or low pressure cylinders are not substitutable with dairy cylinders. This is due in part to these products being:
- 68.1 designed for a specific end use, being open vented, so that they can heat up a large volume of water in a short amount of time; and
- 68.2 subject to a discrete set of regulations administered by the Ministry of Primary Industries.
69. Rheem submitted that there is supply-side substitution: a manufacturer producing mains or low pressure cylinders could easily produce dairy cylinders indicating that dairy cylinders should form part of a wider hot water heater market.<sup>55</sup> While this technically may be the case, certain installers such as [ ] suggested that strength of brand is important,<sup>56</sup> and so mains or low pressure cylinder producers could not sell dairy cylinders without investing in brand in the dairy market.
70. For the purposes of our analysis, we have considered a separate dairy cylinder market.

#### *Tubular Elements*

71. Given Rheem's involvement in the tubular heating element market as a manufacturer, we have assessed the competitive impact of the acquisition on the national markets for the wholesale supply of tubular elements for both new electric cylinders and replacement parts for existing cylinders.

#### **Geographic dimension**

72. We agree with Rheem that the geographic market is national for all the product markets, given the national presence of all major suppliers and customers, the

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<sup>52</sup> Interview with [ ]

<sup>53</sup> Interview with [ ].

<sup>54</sup> Ibid.

<sup>55</sup> Application at [10.5].

<sup>56</sup> Interview with [ ]



national pricing of Rheem and its competitors, and the lack of any apparent regional price discrimination.<sup>57</sup>

73. However, there are freight costs to transport electric cylinders between the North and South Islands and the need for a warehouse and storage facilities so as to service merchants on a 'just in time' basis. Different suppliers also have different regional strengths in branding. However, some plumbers have suggested the importance of branding generally is in decline, particularly in a replacement situation.<sup>58</sup>
74. In electric cylinders, Rheem and Rinnai have the strongest presence in the North Island, while Peter Cocks and Rheem are strong in the South Island. While the geographic market is national, we consider Peter Cocks and Rheem to be closer competitors in the South Island than in the North Island.

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<sup>57</sup> We attempted to ascertain whether there was any variation in pricing between different regions but were unable to find any evidence of such variations.

<sup>58</sup> Interview with [ ]

**Table 2: Estimated market shares by unit sales**

<b>Estimated sales North Island 2014</b>	<b>Rinnai</b>	<b>Valley</b>	<b>Superheat</b>	<b>Sigma</b>	<b>Rheem</b>	<b>PC</b>	<b>Combined</b>
Low and Medium	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Mains Pressure Cylinders	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Dairy Water Cylinders	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Solar	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Gas	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total units	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%	100%

<b>Estimated sales South Island 2014</b>	<b>Rinnai</b>	<b>Valley</b>	<b>Superheat</b>	<b>Sigma</b>	<b>Rheem</b>	<b>PC</b>	<b>Combined</b>
Low and Medium	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Mains Pressure Cylinders	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Dairy Water Cylinders	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Solar	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Gas	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total units	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%	100 %

<b>Estimated sales New Zealand 2014</b>	<b>Rinnai</b>	<b>Valley</b>	<b>Superheat</b>	<b>Sigma</b>	<b>Rheem</b>	<b>PC</b>	<b>Combined</b>
Low and Medium	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Mains Pressure Cylinders	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Dairy Water Cylinders	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Solar	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Gas	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total units	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%	[ ]%	100%

Notes:

PC (Peter Cocks)

Other refers to bespoke cylinders for both commercial and residential applications which for some firms (eg, [ ] and [ ]) are accounted for in Dairy or low pressure.

Some industry participants provided combined sales on solar, mains wetback and heat pump heaters so we have been unable to provide any disaggregated figures. Additionally, the estimates for solar do not include all solar suppliers.

## Competition analysis

### Overview

75. We are satisfied that the horizontal aggregation from the merger is unlikely to result in a substantial lessening of competition in the national markets for the wholesale supply of:
- 75.1 dairy cylinders;
  - 75.2 solar cylinders;
  - 75.3 the mains pressure market; and
  - 75.4 the low pressure market.

### Dairy cylinders

76. Rheem would increase its share of dairy cylinder sales from about [ ] to about [ ] with the acquisition.
77. We consider that Rheem is likely to face effective competition from other market participants: Superheat, Rinnai, and Sigma.<sup>59</sup> Superheat is the largest manufacturer of dairy cylinders in New Zealand at [ ]% with Rinnai and Sigma of a similar size to Peter Cocks, ie, less than [ ]%.
78. Rheem, and to a lesser extent, Rinnai and Superheat are strong in the North Island. Peter Cocks and Superheat have more sales in the South Island. While there are some differing geographic strengths, Superheat and Sigma sell throughout New Zealand.
79. We are also not aware of any reason why any of the existing competitors could not expand their dairy sales.
80. We are therefore satisfied that the aggregation of market share by the proposed merged entity will not result in a substantial lessening of competition.

### Solar cylinders

81. The acquisition would result in the aggregation of market share in respect of solar-cylinders. On the basis of available market share data, Rheem would increase its existing national market share from [ ]% to [ ]%. However, these figures are likely to overstate the estimated market shares for the combined entity. This is because the estimates also include heat pump and wetback water heaters, and does not include the market shares for some other major solar water heater suppliers, such as Solar Group Limited.
82. For reasons similar to those outlined in the mains pressure market, the acquisition is unlikely to raise concerns with respect to solar cylinders in the installation market

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<sup>59</sup> In addition, competition is provided by Longveld, who use Bosch gas units to retrofit electric dairy cylinders.

because of the competition provided by other water heater alternatives such as gas continuous flow, mains pressure and heat pumps. However, a potential concern arises in the replacement of solar cylinders.

83. The available information indicates that if a replacement market was to develop, we consider that existing suppliers of solar cylinders would compete in this market. In particular, Rinnai with its HJ Cooper cylinders would likely supply standard sized solar cylinders, while Sigma would likely supply bespoke cylinders, which are common in this market.

84. [ ]<sup>60</sup>

85. We therefore consider that the competition provided by existing suppliers in this market is likely to be sufficient to constrain the combined entity from exercising any market power.

#### **Mains pressure market**

86. Currently, Rheem is the largest company with approximately [ ] market share, with the balance being shared by Rinnai, Peter Cocks, Bosch, Sigma and Superheat.

87. The acquisition would result in Rheem increasing its market share in the national mains pressure market to [ ]. The aggregation would be most acute in the South Island where it would increase from [ ] to [ ].

88. As outlined above, we consider that gas continuous flow heaters compete with mains pressure cylinders in the installation of new water heaters, and that because manufacturers do not know whether a mains pressure cylinder is intended for installation or replacement, gas continuous flow provides a competitive constraint to the merged entity from increasing the prices of mains pressure cylinders more generally.  
[ ]<sup>61</sup>

89. Rinnai currently supplies [ ]% of the market and is present both in the North and South Islands, although it has a stronger presence in the North Island. Furthermore, there are suppliers who intend to enter or expand their presence in the supply of mains pressure cylinders.  
[ ]<sup>62</sup>

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<sup>60</sup> Interview with [ ]

<sup>61</sup> Rheem response to information request, 22 December 2015.

<sup>62</sup> [ ]

90. [ ],<sup>63</sup>  
[ ].<sup>64</sup>

91. We are therefore satisfied that the acquisition will not have, or is not likely to have, a substantial lessening of competition in the mains pressure market.

### **Low pressure market**

#### *Existing competition*

92. Rheem has approximately a [ ] share of low pressure sales. Peter Cocks is the second largest with [ ], Rinnai with [ ], and Sigma with [ ]. Rheem would, therefore, have [ ] of low pressure sales post acquisition.

93. While all these four largest manufacturers sell throughout the country, Rheem, Rinnai and to a smaller extent Sigma, are the larger manufacturers in the North Island, and Rheem and Peter Cocks are the larger manufacturers in the South Island. While Rinnai's sales are likely to provide some competitive constraint, we focus on the likelihood of entry and expansion given that Rinnai, Sigma, and the other participants in this market are relatively small and currently focussed on North Island sales. Those manufacturers would need to expand, particularly with a South Island focus, or new manufacturers would have to enter to constrain Rheem post-merger.

#### *Potential competition*

94. In this section we consider whether existing manufacturers could expand or new competitors would enter and effectively compete with the merged entity if prices increased. The threat of entry must be sufficient to constrain market power. This requires entry to be likely, sufficient in extent, and timely (referred to as the 'LET test').<sup>65</sup> As part of this analysis we need to consider the conditions for entry and expansion and how potential competitors to the merged entity would meet such conditions.

#### *Conditions for entry and expansion*

95. While any sheet metal company can manufacture low pressure cylinders, producing a sufficient quantity and variety of cylinders, gaining access to merchants and brand/reputation are conditions of entry and expansion that a new entrant or an existing provider must address.<sup>66</sup>

96. Discussions with plumbers suggest that when they are undertaking a replacement job, they consider that the choice of water heater will be influenced by the following factors.<sup>67</sup>

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<sup>63</sup> [ ]

<sup>64</sup> Interview with [ ]

<sup>65</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at [3.96].

<sup>66</sup> Interview with [ ]

<sup>67</sup> Interviews with: [ ]

- 96.1 compatibility with existing plumbing infrastructure;
  - 96.2 availability of a water heater at a merchant’s store;<sup>68</sup>
  - 96.3 brand reputation of the manufacturer, including warranties, technical support and supporting local/New Zealand firms; and
  - 96.4 end customer preferences such as speed of replacement, brand awareness and cost.
97. While manufacturers cannot influence the compatibility of existing plumbing infrastructure, ensuring availability at merchants has been identified as a condition of expansion by [ ]<sup>69</sup> Merchants are unwilling to stock products that do not have a brand reputation or where they cannot sell sufficient volumes.<sup>70</sup> In order to secure stock levels with merchants, manufacturers need to establish brands either with plumbers or with end customers.<sup>71</sup>
98. These conditions exist in both the mains pressure and low pressure markets. However, due to low pressure being a declining market and the tendency for like-for-like replacement, requiring just in time delivery,<sup>72</sup> we expect these conditions to be more apparent in the low pressure market.  
[ ]

Entry or expansion by domestic manufacturers

*Rinnai*

99. [ ]<sup>73</sup>
100. [ ]<sup>74</sup>
101. However, the merchants we spoke to advised us that in the event the merged entity was to exercise market power they could readily switch to Rinnai, which for most merchants is one of its existing suppliers.<sup>75</sup>
102. As an existing manufacturer of low pressure cylinders, Rinnai represents an alternative source of supply but

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<sup>68</sup> We note that most of the plumbing merchants generally stock a maximum of three brands of hot water heaters, although alternative brands may be displayed. For example, interview with [ ].

<sup>69</sup> [ ] Interviews with [ ]

<sup>70</sup> For instance, interview with [ ]

<sup>71</sup> Interview with [ ]

<sup>72</sup> Interview with Dux, 14 December 2015.

<sup>73</sup> Interview with [ ].

<sup>74</sup> [ ]

<sup>75</sup> Interviews with [ ]

[ ],we are not satisfied that expansion by Rinnai is likely to sufficiently constrain the merged entity if it were to raise prices.

*Superheat*

103. Superheat currently supply [ ] low pressure cylinders to the market. Its range is similar to that of Rheem and Peter Cocks and is primarily South Island focussed with an estimated [ ] of its sales in the South Island. However, after the Christchurch earthquake, Superheat was able to increase production to around [ ] low pressure cylinders a year, which it sustained for 11 months.<sup>76</sup>

104. [ ]  
].<sup>77</sup>

105. [ ]  
].<sup>78</sup>

106. While Superheat’s products are stocked in some merchant’s stores, its presence is not as strong as the merger participants or Rinnai. However, feedback from merchants is that Superheat’s products are of good quality,<sup>79</sup> and [ ]<sup>80</sup>.

107. In summary, Superheat has already demonstrated its ability to expand output of low pressure cylinders during the Christchurch earthquake, and [ ]. Therefore, we consider Superheat is likely to provide a constraint post-acquisition.

*Sigma*

108. Sigma currently sells around [ ] low pressure cylinders a year under their Triumph brand, [ ] of the low pressure market. [ ] of its sales are in the North Island. Sigma’s range is similar to that of Rheem and Peter Cocks and it currently produces the most popular capacities (i.e. 180l and 135l, in four varieties).<sup>81</sup>

109. [ ]  
].<sup>82</sup>  
[ ]  
].

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<sup>76</sup> Interview with Superheat, 28 January 2016.

<sup>77</sup> [ ]

<sup>78</sup> [ ]

<sup>79</sup> Interview with [ ]

<sup>80</sup> Interview with [ ]

<sup>81</sup> Interview with Sigma, 28 January 2016.]

<sup>82</sup> Interview with [ ].

110. [

].<sup>83</sup>

111. To effectively compete to a sufficient extent in the low pressure market, Sigma would need to carry a wider range of cylinders on the merchant’s shop floor. Sigma’s product range is already similar to that of Rheem. It will need to increase brand awareness in order to be an effective competitor to the merged entity. [ ].

112. [ ].

113. With respect to access to merchants, Sigma is already stocked in some Plumbing World outlets, one of the two large nationwide chains. [ ].<sup>84</sup>

114. In the longer term, as the market for low pressure continues to decline, [ ].<sup>85</sup>

115. [ ].<sup>86</sup> We consider that Sigma has the ability and willingness to expand in a timely manner, and while its presence in the major merchant’s store is relatively small at present, it is likely to provide a constraint on the combined entity if it were to exercise market power.

Entry by Imports

116. The issue of access to merchants is resolved if an existing merchant self-supplies by importing an overseas brand or has product manufactured offshore.

*Imports from Australia*

117. In terms of importing cylinders from Australia, the difference between New Zealand and Australian Minimum Efficiency Performance Standards (MEPS) levels has an impact on the imported electric cylinders from Australia. The uncertainty of the application of Australian MEPS standards on electric cylinders in New Zealand was reflected in our discussions with interested parties, with some merchants stating that Australian standards applied, while others considered that they did not.<sup>87</sup> Our view is that this uncertainty does not facilitate easy imports of both low

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<sup>83</sup> Interview with [ ]

<sup>84</sup> Interview with [ ]

<sup>85</sup> Interview with [ ]

<sup>86</sup> Interview with [ ]

<sup>87</sup> Interviews with [ ]



and mains pressure cylinders from Australia. Transport costs were also cited as a constraint to expansion.<sup>88</sup>

118. We understand that the market for low pressure cylinders in Australia is very small relative to other water heater alternatives and so the incentive to import low pressure cylinders from Australia is diminished.<sup>89</sup>

[

].<sup>90</sup>

119. In summary, therefore, we do not consider that such an entry into the low pressure market through imports of low pressure cylinders would be likely, to be sufficient in extent or timely.

### Conclusion on unilateral effects

120. We are satisfied that the existing competition in the mains pressure market, solar-cylinder market and dairy cylinder market will constrain the merged party from substantially raising prices. In the low pressure market, we are satisfied that the ability and willingness of existing competitors to expand meets the LET test and that such expansion will constrain the merged entity from substantially lessening competition in this market.

### Vertical effects

121. We have assessed whether the acquisition is likely to give rise to vertical effects. The acquisition will not result in any new vertical integration, only a strengthening of existing vertical integration.
122. Our view is that the strengthening of vertical integration that would result from the acquisition in respect of tubular elements for electric cylinders is unlikely to result in a substantial lessening of competition. [
- ].<sup>91</sup>
123. Furthermore, [ ], we do not consider that this will give rise to a substantial lessening of competition because:

- 123.1 Rheem is unlikely to have any market power in the upstream element market due to the presence of strong alternative competitors, including Smith Elements and Controls Limited and BJC Elements, both of which are major competitors in this market;

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<sup>88</sup> Interview with [ ]

<sup>89</sup> Interview with [ ]

<sup>90</sup> Interviews with [ ]

<sup>91</sup> Rheem's response to the Commission's request for further information, 3 November 2015.

123.2 Rheem is unlikely to be able, or have the incentive to leverage any market power in the upstream market to foreclose its rivals from obtaining supplies of elements or by raising rivals' costs for these products; and

123.3 as noted above, Rheem is unlikely to be able, or have the incentive to leverage any market power in the downstream mains pressure, low pressure and solar cylinder markets.

#### **Coordinated effects**

124. We have assessed whether the acquisition may give rise to coordinated effects. This included consideration of whether the acquisition may provide the conditions for the combined entity and its rivals to coordinate by allocating customers between themselves.

125. The affected markets have some features that may facilitate coordination. These include:

125.1 some homogenous products (in the most common products);

125.2 a small number of competitors; and

125.3 stable demand, few cost shocks and little innovation.

126. Factors that make coordinated effects less likely include:

126.1 asymmetries in market share and cost structures;

126.2 the diversity of product range in outlier sizes and bespoke manufacture;

126.3 the lack of price transparency at the wholesale level; and

126.4 the presence of fringe competitors, although they have had limited success in obtaining access to merchants.

127. These factors will continue unaffected in the factual. However, we have found no evidence of coordination between the parties. The acquisition in our view will not make coordination more likely so as to result in a substantial lessening of competition.

## **Determination**

128. We are 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.
129. Pursuant to section 66(3)(a)/(b) of the Act, the Commerce Commission determines to give clearance for Rheem to acquire the business and assets of Peter Cocks.

Dated this 3<sup>rd</sup> day of February 2016

Dr Mark Berry  
Chairman