

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE****Non-price Effects of Mergers - Note by New Zealand****6 June 2018**

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More documents related to this discussion can be found at www.oecd.org/daf/competition/non-price-effects-of-mergers.htm.

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New Zealand

1. The New Zealand merger regime

1. Section 47 of The Commerce Act 1986 (the Act) prohibits acquisitions that would have, or would be likely to have, the effect of substantially lessening competition (SLC) in a market in New Zealand. The SLC test compares the likely state of competition if the merger proceeds with the likely state of competition if the merger does not proceed. This is equivalent to asking whether the merger confers market power such that prices can be raised above competitive levels, or non-price factors such as quality or service can be reduced below competitive levels.¹ The Commission and third parties may file proceedings before the High Court to enforce section 47.

2. New Zealand has a voluntary clearance regime, under which parties can apply to the Commission for clearance. If a merger receives clearance, section 47 is deemed not to apply to the merger for a period of one year.² The onus is on the applicant to satisfy the Commission that the merger is unlikely to substantially lessen competition. If the Commission is not satisfied, or if it is left in doubt³, then clearance is not granted.⁴

3. New Zealand also has a voluntary authorisation regime. The Commerce Commission (the Commission) grants authorisation for a merger if it is satisfied that the merger will be likely to result in such a benefit to the public that it should be permitted, despite any SLC. Again, the onus is placed on the applicant to satisfy the Commission that such benefits would flow from the merger.

4. The authorisation regime therefore widens the consideration of the effects of the merger to include the public benefits and detriments. All merger specific efficiencies, including productive efficiencies which accrue solely to the producer, are considered under this test.⁵

¹ Mergers and Acquisitions Guidelines (2013). Available at <http://www.comcom.govt.nz/business-competition/guidelines-2/mergers-and-acquisitions-guidelines/>

² Section 96 Commerce Act 1986.

³ The Commission can be left in doubt if it is unable to exclude a real chance of a substantial lessening of competition. The source of doubt is irrelevant. There is no significant difference between uncertainty associated with deficiencies in the evidence and uncertainty associated with the impracticality of predicting future events.

⁴ In *Commerce Commission v Woolworths Ltd & Ors* (2008) 12 TCLR 194 (CA) 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”. However, the Court also indicated at [97] that we should make factual assessments using the balance of probabilities.

⁵ Authorisation Guidelines (2013). Available at <http://www.comcom.govt.nz/business-competition/guidelines-2/authorisation-guidelines/>

2. Non-price effects in merger clearance reviews in New Zealand

5. *The Warehouse*⁶ decision provides a clear example of how non-price effects are taken into account in merger analysis in New Zealand. In 2007 the two incumbent supermarket chains, Woolworths Ltd and the Foodstuffs co-operatives, each separately sought to acquire an entrant, Warehouse Extra.

6. The Commission declined the clearance applications arguing that “there is a real risk that prices would be materially higher, and quality, service and innovation materially lower, than in the counterfactual through either or both non-coordinated or coordinated effects”.⁷

7. The merging parties appealed to the High Court, which overturned the Commission’s decision. However, in making its decision, the High Court noted that “[o]ther indicia of rivalry also need to be considered. Prices are only one dimension of competition and are only one factor that consumers take into account when purchasing goods and services. Here the evidence shows that [the competitors] compete not simply on the basis of price but also on the basis of the range of the goods that they have on offer, the quality of the merchandise they offer, and the services they provide to consumers”.⁸

8. The Commission appealed this decision to the Court of Appeal, which ruled in the Commission’s favour.⁹ On innovation, the Court of Appeal found that the Warehouse sought to “establish a market niche for itself through an innovative approach”¹⁰ in an industry with high barriers to entry. The court was concerned that the merger would eliminate The Warehouse Extra innovation, “before it has had a chance to prove itself as a matter for concern, especially as this concept is the only realistic source of ongoing competition to Woolworths and Foodstuffs in the near future”.¹¹

9. Further, on price and non-price effects, the Court of Appeal could “see no reason why it would not have a significant effect on the PQRS [price-quality-range-service] packages offered by Woolworths and Foodstuffs in those markets”.¹² The Court of Appeal accepted that The Warehouse Extra was unlikely to be a price leader or to start a price war but if it offered “a competitive PQRS package”¹³ the incumbents would be forced to respond in the relevant markets. The court added that since neither incumbent would “be able to replicate Extra’s offering involving general merchandise ... other competitive responses, including price reductions, would be required”.¹⁴ Finally, the court found that although the incumbent’s “response on price may not be of the magnitude that

⁶ *Commerce Commission v Woolworths Ltd & Ors* [2008] 12 TCLR 194 (CA).

⁷ *Ibid.* As summarised in the CA judgement, see from paragraph 165.

⁸ *Woolworths Ltd & Ors v Commerce Commission* (2008) NZBLC 102, 128 (HC) at [156].

⁹ *Commerce Commission v Woolworths Ltd & Ors* (2008) 12 TCLR 194 (CA).

¹⁰ *Ibid.* at [200].

¹¹ *Ibid.* at [205].

¹² *Ibid.* at [201].

¹³ *Ibid.* at [203].

¹⁴ *Ibid.* at [203].

the High Court saw as competitively significant ... there is a real possibility that their response on all aspects of the PQRS package will be of real competitive significance”.¹⁵

2.1. Analysis in practice

10. Consistent with the *Warehouse* judgment, the Commission’s Mergers and Acquisitions Guidelines include consideration of non-price effects such as “a reduction in quality, range, level of innovation, service or any other element of competition valued by buyers” in the assessment of whether a merger is likely to substantially lessen competition.¹⁶

11. Evidence of non-price elements of competition is typically gathered through interviews with market participants and stakeholders; analysing internal documents and market research reports.¹⁷ However, the Commission has also undertaken data analysis in cases where such analysis has proved necessary or informative.

12. In considering how mergers are likely to impact competition, the Commission considers both price and non-price effects throughout the merger assessment. Non-price elements of competition are often considered when defining the relevant markets, understanding how competition takes place, consumer preferences, as well as the likely effects of a merger.

13. For example, the Commission defines markets in the way that best isolates the key competition issues that arise from the merger. All relevant competitive constraints, and the extent of those constraints, are considered. This includes how differentiated market offerings and consumer preferences may be, to what extent firms compete on the quality of service and building customer relationships, the range of goods and service offered by market participants, the rate of investment and improvement firms undertake, as well as resulting price differences between market offerings.

14. Following this framework, the Commission has considered vertical differentiation, such as in the *Coty/ Proctor&Gamble*¹⁸ merger where perfumes were delineated by quality into ‘prestige’ and ‘mass market’ fragrance categories.

15. The Commission has also recognised where differentiated ‘PQRS’ offerings have impacted on the closeness of competition between firms, and thereby on the relevant market definition. For example, in the *Staples/Office Depot* clearance decision¹⁹ in 2015 the Commission considered that the relevant office stationary suppliers differed by the range of products they supplied as well as their logistics and service offerings. Very small customers with irregular product requirements valued retail stores, SMEs valued both retail stores and local connections, while larger customers required more significant servicing and delivery, as well as a broader range and volume of product. This meant that larger and smaller customer groups faced different sets of competitive alternatives and, as such, different competitive effects from the merger were considered for each group. The

¹⁵ *Ibid.* at [205].

¹⁶ Mergers and Acquisitions Guidelines (2013), fn 1.

¹⁷ Particularly in the cases involving consumer goods.

¹⁸ *Coty Inc. and The Proctor and Gamble Company* [2016] NZCC 4

¹⁹ *Staples Inc/Office Depot Inc* [2015] NZCC 14

Commission defined separate markets for small office and home office businesses; small and medium enterprises; larger corporate entities; and government agencies.

16. The Commission has also considered market dynamism in a number of cases, although it has not been a panacea to competition concerns. In some of those cases the Commission considered that market dynamism would facilitate entry and increase the risk of customers switching. For example, in the merger of the *Expedia/ Wotif* online travel agencies, the Commission concluded that “competition is facilitated by the dynamic nature of the market, in particular, the growth of metasearch websites”.²⁰

17. However, in other cases market dynamism was considered to be at risk if the merger resulted in reduced incentives to invest in innovation - such as *Vodafone/Sky*.²¹ In this proposed vertical merger between Vodafone, a mobile and broadband provider, and Sky, a pay TV provider with exclusive rights over premium live sports content, the Commission recognised that the relevant service markets were undergoing a period of significant change. In particular, technological convergence had facilitated the increased consumption of television content using broadband and mobile services.

18. The emergence of bundled services, such as broadband and pay TV, as a key method of competition between broadband providers raised a significant risk that a bundled pay TV and broadband/mobile offering from the merged entity would foreclose or stymie the growth of rival broadband/mobile providers. This scenario would also have played out against a backdrop of once-off competition for customers during the rollout of the ultra-fast broadband network, after which customers would have become less likely to switch. The Commission was concerned that if Vodafone’s rivals were rendered competitively less effective in the future, then there would be a real chance that these rivals would lower their levels of investment and innovation and, in so doing, weaken both the price and non-price competition faced by the merged entity. The Commission was left in doubt in that it could not exclude a real chance of a substantial lessening of competition.

19. The Commission has, in various mergers, considered whether the range of innovative new products may be affected by a merger. In the following three examples, the Commission considered whether the aggregation of distributors would lead to a reduction in the range of innovative new products finding their way to market. For example, in the *Coty/ Proctor&Gamble*²² merger the Commission considered that the merged entity would not have an incentive to reduce the range of fragrances it purchased from fragrance developers or ‘noses’, despite sales cannibalisation, because of the existing competitive pressures it faced and would continue to face.

20. Similarly, in the *EMI/Universal*²³ record label and *Penguin/Randomhouse*²⁴ book publishing mergers, the Commission considered whether new talent acquisition of either music artists or authors would be impacted by the acquisitions. In both cases the

²⁰ *Expedia, Inc and Wotif.com Holdings Limited* [2014] NZCC 3, at [47.3]

²¹ *Vodafone Europe B.V. and Sky Network Television Limited* [2017] NZCC 1 and 2 at [515], [533.1].

²² *Coty Inc. and The proctor and Gamble Company* [2016] NZCC 4

²³ *Universal Music Holdings Limited and EMI Group Global Limited* [2012] NZCC 14.

²⁴ *Bertelsmann SE & Co. and Pearson plc* [2013] NZCC 6.

Commission found that existing competition would preserve the competitive dynamics in the relevant markets.

21. As the conditions of competition are assessed with non-price factors in mind, so are the Commission's theories of harm and the ultimate assessment of likely effects. For example, in the *Aon/FPIS* application²⁵, the Commission declined to grant clearance because the acquisition would result in significant overlap for sprinkler inspections in each of the affected geographic markets. The inspection companies competed on a mixture of factors, including customer relationships, the quality of the inspector's service, and the inspector's pricing. The theories of harm and competitive assessment in this case focused more on the prospect for price increases. This is because the evidence suggested that customers purchasing fire inspection services were more sensitive to quality decreases than to price increases. As such, some customers may have tolerated modest price increases so long as service levels are maintained. In other cases, where customers are found to be more sensitive to price increases, we might focus more on the prospect for quality reductions.

3. Authorisation regime

22. The Commission is one of the few competition agencies that can consider merger effects outside of the standard SLC analysis through the authorisation regime. Many of the relevant effects considered under the authorisation test are non-price effects.

23. The Commission has assessed a higher number of merger authorisation applications in recent years which has required it to consider the benefits and detriments associated with non-price effects more frequently in this context.

24. The benefits and detriments the Commission has taken into consideration in authorisation assessments have to be transaction specific, in that they arise as a result of the transaction. The Commission only considers relevant benefits and detriments that are likely as part of its assessment.²⁶

25. These assessments have included productive, allocative and dynamic (in)efficiencies arising from the merger. Although the Act does not define 'benefit to the public', the New Zealand courts have clarified that it means "anything of value to the community generally, any contribution to the aims pursued by the society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress".²⁷ In *AMPS-A*, the Court recognised that "[e]fficiency considerations, positive and negative, are relevant in the assessment of

²⁵ *Aon New Zealand and Fire Protection Inspection Services Limited* [2017] NZCC 3, at [38]

²⁶ See *Woolworths Ltd & Ors v Commerce Commission* (2008) NZBLC 102, 128 (HC) at [144].

²⁷ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473 at 530, *Air New Zealand & Anor v Commerce Commission & Ors (No 6)* (2004) 11 TCLR 347 at [319], quoting *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17242 and in *Re Rural Traders Co-operative (WA) Ltd* (1979) ATPR 40-110 at 18123.

both benefit and detriment but clearly do not exhaust society's interest in the business conduct".²⁸

26. As examples, the Commission took into consideration non-price effects in the first *Cavalier/NZ Wool Services* merger application.²⁹ Cavalier Wool sought to acquire WSI in order to rationalise the two companies' wool scouring operations³⁰ from five plants to just two – one on each of the North and South Islands. This rationalisation was considered necessary in the face of declining sheep numbers, overcapacity and competition from Chinese scourers. The Commission considered allocative efficiency losses through market power as well as a range of efficiencies including cost savings, increased capacity utilisation of the wool scouring equipment and the benefit of freed up surplus land from plant rationalisation. The Commission also considered Cavalier's claims that, owing to innovations introduced at its own plants, it would be able to produce scoured wool of superior brightness to that produced by WSI's scouring plants that would allow greater returns from the sale of New Zealand's wool clip.³¹ While the Commission recognised the potential of significant public benefits if improved brightness could be achieved, it was not satisfied that this benefit would eventuate.

27. More recently, and under current consideration by the courts, is the Commission's decline of the merger between New Zealand's incumbent media firms, *NZME/Fairfax*.³² These firms sought to merge in the face of declining advertising revenues and a shift to online content. The Commission considered both the quantifiable fixed and variable cost savings from the merger (such as editorial, print and management costs) as well as unquantified benefits such as reduced duplication and free-riding of rivals on news stories. These efficiency gains were considered alongside largely unquantified detriments such as the loss of media plurality, reduced quality of news content and the presentation and delivery of news content in certain print publications and in online New Zealand news.³³

²⁸ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473 (HC) at 528.

²⁹ *Cavalier Wool Holdings Ltd and NZ Wool Services International Ltd* Decision 725 (2011) at [466] – [500]. This application was authorised by the Commission but then expired. The parties reapplied for authorisation in 2016 which was also approved.

³⁰ Wool scouring is a process of cleaning wool after it has been shorn and classed.

³¹ Cavalier claimed that its intended improvements to the rationalised plants would increase the brightness of the wool by between one and two Y value units (the wool industry's measure of brightness or whiteness). A one unit increase in the base Y value of wool could result in a sale price increase of approximately 4 cents per kilogram of wool.

³² *NZME Limited and Fairfax New Zealand Limited* [2017] NZCC 8 at [193] to [1659].

³³ In terms of online New Zealand news content, the Commission considered the dimensions of quality to include coverage of important and relevant news topics; coverage of a variety of perspectives, opinions and viewpoints on common news topics; in-depth analysis and investigation; and timely and accurate reporting. In terms of the presentation and delivery of online New Zealand news, the Commission considered that the dimensions of quality included the design and format of the online platforms; and inventive ways of presenting individual stories.

4. Quantifying non-price effects

28. The Commission is not generally required to quantify non-price effects (or, for that matter, price effects) under the SLC test for section 47 or clearance considerations. However, under the authorisation regime, the courts have held that the Commission should “attempt so far as possible to quantify benefits and detriments [of the merger to the public] rather than rely on purely intuitive judgment”.³⁴ Non-price effects are included in the concepts of benefits and detriments.

29. The Commission has endeavoured to make pragmatic and commercial assessments of what is likely to occur in the future with and without the merger, based on the information obtained throughout an investigation. Where quantification is possible, the Commission sometimes considers a range of likely benefits and detriments. For example, in the second *Cavalier/NZ Wool Services* merger application in 2016³⁵ the Commission tested the sensitivity of its 5-year net public benefits calculation over a longer 10-year period, and estimated the net impact of the transaction assuming the lowest likely value of benefits and the highest likely value of detriments and alternatively the highest likely value of benefits and the lowest likely value of detriments.³⁶ This approach allowed the Commission to consider a range of likely scenarios and evaluate the likelihood of such scenarios eventuating.

30. However, the courts have affirmed that the Commission and the courts cannot be compelled to perform a quantitative analysis of qualitative variables,³⁷ “[n]or should its qualitative judgment be reserved as a mere backstop.... Qualitative factors can be given independent and, where appropriate, decisive weight; it follows that non-quantifiable factors need not assume a merely supplementary function in a largely arithmetical exercise, as supposed in contemporary practice”.³⁸

³⁴ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473 (HC) at 447, *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZCA 560 at 739 – 740.

³⁵ *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZCA 560.

³⁶ *Ibid.* See page 109.

³⁷ *Godfrey Hirst v Commerce Commission* [2016] NZCA 560 at 740 at [36]. See *New Zealand Bus Ltd v Commerce Commission* [2007] NZCA 502, [2008] 3 NZLR 433

³⁸ *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZCA 560; (2016) 14 TCLR 517 at [37] - [38]