



THL/Apollo: review of certain aspects of the Commerce Commission's Statement of Issues

A report for MinterEllisonRuddWatts

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Public version: confidential information has been redacted

1. Introduction

1. The New Zealand Commerce Commission is assessing the proposed merger of Tourism Holdings Limited (“THL”) and Apollo Tourism and Leisure Limited (“Apollo”), and has issued a Statement of Issues (“SOI”) dated 11 March 2022. We have been asked by MinterEllisonRuddWatts, counsel to THL, to review certain aspects of the SOI.
2. Confidential information in this report is identified in square brackets and shading as follows:
 - a. Purple shading is information confidential to THL;
 - b. Blue shading is information confidential to Apollo; and
 - c. Yellow shading is counsel-only information that should not be seen by either THL or Apollo.

2. Market definition for motorhome and campervans rentals

2.1. Demand-side

3. The Commission states in the SOI (at [46]) that there is not significant demand-side substitutability between motorhomes and campervans, citing evidence that “there are different customer bases and product propositions for motorhomes and campervan rentals”. The Commission states also (at [21]):

A motorhome usually provides a broad range of amenities, including a small living area, beds, kitchen, toilet and shower, whereas a campervan is much smaller and may not have the same range of facilities (eg, toilet and shower).
4. However, there is no clear division between motorhomes and campervans in their attributes, e.g., berth numbers, toilet and showers, kitchen facilities, etc. Rather, there is clear overlap in the attributes of these categories, for example:¹
 - a. THL, under its Britz brand, offers both the Discovery, a 4-berth motorhome (with toilet and shower),² and the Voyager (with a toilet but no shower), a 4-berth campervan;³
 - b. Apollo offers the 4-berth Euro Camper motorhome⁴ and the 2-berth Euro Tourer campervan,⁵ both of which have kitchen facilities, toilet and showers; and
 - c. Wendekreisen offers the 4-berth Budget motorhome with kitchen facilities, toilet and shower,⁶ and the 2-berth Koru ST campervan with kitchen facilities, portable toilet and shower.⁷

¹ Throughout this report we classify vehicles as either “motorhome” or “campervan” based on the Commission’s distinction (at [21] of the SOI): “a motorhome is characterised as a purpose-built vehicle constructed on a chassis approximately 7m in length, and a campervan as a converted van-type vehicle, approximately 5m in length (eg, Toyota Hiace).”

² <https://www.britz.com/nz/en/campervan-hire/4-berth-discovery>

³ <https://www.britz.com/nz/en/campervan-hire/4-berth-voyager>

⁴ <https://www.apollocamper.co.nz/vehicles/motorhomes/euro-camper>

⁵ <https://www.apollocamper.co.nz/vehicles/campervans/euro-tourer>

⁶ <https://www.wendekreisen.co.nz/campervans/campervan.aspx?VehID=8>

⁷ <https://www.wendekreisen.co.nz/campervans/campervan.aspx?VehID=22>

5. To suggest that motorhomes and campervans are not in the same market (or, if in different markets, are not a constraint on each other), risks an arbitrary distinction being drawn, and the constraint from those products deemed outside the relevant market being understated. To be more specific, a risk of the approach posited in the SOI is that the constraint from campervans on motorhomes will be understated, because of a seemingly arbitrary distinction between motorhomes and campervans.
6. We note in this regard that the Commission itself acknowledges (at [105]) that there may be a degree of constraint from switching from THL/Apollo 2-berth motorhomes to a 2-berth campervan of a rival provider. The Commission's view, though, appears to be that this constraint is limited because 2-berth motorhomes make up only a small proportion of THL and Apollo's fleets. However, rival campervan providers also provide models with more than 2 berths,⁸ so on the Commission's logic there could be switching across the larger berth campervans and motorhomes. Moreover, on the Commission's preliminary view (with which we agree) that different sized motorhomes are in the same market (at [50]), any constraint on 2-berth motorhomes from 2-berth campervans would also extend to the other berth sizes offered by THL and Apollo.
7. It is important also to note that, in applying the hypothetical monopolist test ("HMT") in market definition, there does not necessarily need to be a large proportion of customers switching to imply a constraint. The HMT tests whether a sufficient number of customers would switch so as to undermine the profitability of the SSNIP. It is these "marginal" customers, those willing to switch to alternatives, that would protect the remaining inframarginal customers from a price rise.⁹
8. As stated by Malcolm Coate and Jeffrey Fischer (2008, p.1034), two economists with the US Federal Trade Commission:¹⁰
In defining markets, it is the willingness of the marginal customers to substitute among suppliers that determines the scope of the market...
9. As we demonstrated in our 18 February 2022 report (filed with the Commission in response to the Statement of Preliminary Issues), a hypothetical monopolist of rental recreational vehicles ("RVs") would be particularly sensitive to volume losses, because of the high fixed costs involved.
10. In order to analyse these issues further, we have requested and analysed pricing data from THL and Apollo. We received data from THL on its average daily yield by brand and size, which we analysed in our 18 February 2022 report. For the purposes of this report, we have categorised the THL brands and sizes as either motorhomes or campervans. We have categorised the 2-3 berth and NTS RVs as campervans,¹¹ and the 4-6 berth RVs as motorhomes.
11. In Figure 1 we show the monthly average yield for THL motorhomes (dotted lines) and campervans (solid lines).¹² This shows [REDACTED].

⁸ See, for example, the 4-berth Jucy Condo (<https://www.jucy.com/nz/en/campervans/nz-campervan-range/jucy-condo/#embed-item-51>) and the 2-5 berth Travellers Autobarn Hi5 (<https://www.travellers-autobarn.co.nz/campervan-hire-new-zealand/hi5-campervan/>).

⁹ Assuming that the hypothetical monopolist does not have the ability to price discriminate between the marginal and inframarginal customers.

¹⁰ Malcolm B. Coate and Jeffrey H. Fischer (2008), "A Practical Guide to the Hypothetical Monopolist Test for Market Definition", *Journal of Competition Law and Economics*, 4(4), 1031-1064.

¹¹ Mighty and Britz have a 4-berth campervan, but these vehicles have no shower and only a portable toilet, so they are picked up in the NTS category.

¹² The monthly average is the unweighted arithmetic average of the average daily yields in a given month.

Figure 1: [REDACTED]

12. We have also calculated the correlation coefficients across each of the combinations of products shown in Figure 1 – the correlation matrix is shown in Table 1. The correlations [REDACTED]. The [REDACTED].

Table 1: [REDACTED]

13. We also received data from Apollo on its average daily yield, by individual product, but averaged on a monthly basis. We have categorised all the different products as either a motorhome or campervan. In Figure 2 we show the average yield for motorhomes (dotted lines) and campervans (solid lines), for Apollo’s different brands of campervans and motorhomes. This shows [REDACTED].

Figure 2: [REDACTED]

14. In Table 2 we report the correlation matrix for the combinations of products shown in Figure 2. The correlations are [REDACTED]. The [REDACTED].

Table 2: [REDACTED]

15. In conclusion:
- a. It is difficult to identify a clear delineation between motorhomes and campervans from the demand-side; and
 - b. There is empirical evidence consistent with demand-side substitutability between motorhomes and campervans. As discussed in our 18 February 2022 report, the proportion of customers that would need to switch to undermine a SSNIP will be relatively low in this high fixed cost industry.

2.2. Supply-side

16. Regarding supply-side substitutability between motorhomes and campervans, the Commission states (at [47] and [48] of the SOI) that motorhome and campervan providers operate different business models, with motorhome providers having a “build, rent, sell” approach, while campervan providers purchase used vehicles, rent them out, then sell or scrap the vehicles. The Commission states that ([48]):

This suggests that campervan rental operators may find it relatively more costly and difficult to switch to supplying motorhomes.

17. The key difference in the business models as set out by the Commission is the “build” aspect of motorhomes. The Commission is asserting that motorhome rental companies tend to have their own manufacturing facilities. If this was correct, then we would agree with the Commission that supply-side substitutability from campervan rentals would be difficult.
18. However, as described in THL’s submission in response to the SOI (at [2.31] and [2.32]), motorhome rental companies are generally not vertically integrated into manufacturing, but rather acquire motorhomes from third party manufacturers. Indeed, Apollo does not manufacture its own motorhomes in New Zealand.
19. Accordingly, the core distinction between business models as set out in the SOI falls away.
20. In general, it is difficult to see why a rental provider of campervans could not quickly expand into supplying motorhomes in response to a price increase. It would simply be a matter of acquiring the different vehicles and marketing them. RVs (including motorhomes) are not sunk – they can be used for the rental provider’s other brands as they age and/or be sold to private owners. They are also mobile, in that vehicles can be shifted across New Zealand quickly and easily. Capacity can be expanded incrementally, by purchasing additional RVs as demand expands.

21. The “fluidity” of RV capacity is demonstrated by THL’s and Apollo’s fleet size relative to fluctuations in the number of international tourists to New Zealand. In Figure 3 below we have plotted international tourist visitors to New Zealand (on the left y-axis) and THL’s fleet size as at the end of the financial year (on the right y-axis).¹³ It can be seen that there is [REDACTED].
22. Similarly, in Figure 4 we plot international tourist visitors against Apollo’s fleet size.¹⁴ This shows [REDACTED].
23. There is also evidence of changes in fleet sizes for other providers – for example, THL’s submission in response to the SOI notes (at [4.9]) that McRent entered the market in 2017 and within two years had built up its fleet to approximately [REDACTED] vehicles. THL also estimates (at [4.10] of its submission) that McRent’s fleet size has [REDACTED], presumably as a result of the pandemic.

Figure 3: [REDACTED]

Figure 4: [REDACTED]

24. In summary, given the evidence above that capacity is fluid, it seems likely that campervan operators could quickly and easily expand into the provision of motorhomes, if given a profit incentive to do so.

3. Expansion by existing motorhome rental operators

25. In the SOI, the Commission assesses the constraint from existing motorhome rental operators, on the basis of its view that there are separate product markets for the rental of motorhomes and campervans. For the reasons set out above, we disagree with this view. Nonetheless, for the purposes of this section, we take as given the Commission’s view on the relevant markets and review its analysis of the constraint from the expansion of existing motorhome rental providers.

3.1. Foreclosure

26. In assessing the conditions for expansion by existing motorhome rental operators, the Commission highlights some foreclosure concerns raised by market participants (at [83], footnotes omitted):

Some expressed concerns about the potential for the merged entity to use its combined bargaining power to foreclose rival motorhome rental operators from access to wholesalers, travel agents and/or web consolidators (suggesting a strategic or behavioural barrier). We are still considering these concerns (including whether anything would change with the Proposed Acquisition) and invite further comment on this point.

27. This wording implies that the Commission has not yet formed even a preliminary view on a foreclosure theory of harm. We think the Commission’s caution is appropriate - clearly a lot more facts and analysis would be required to make out a foreclosure theory of harm, and at the moment the theory seems speculative. Any analysis would also have to account for possible efficiencies from contracts with distributors.

¹³ The international tourist data goes through to 2020, while the THL data runs from 2005 through to 2021.

¹⁴ The Apollo data runs from 2012 through to 2021.

28. However, any further analysis is unnecessary, because a fundamental requirement for a foreclosure theory of harm is market power.¹⁵ If the Commission were to find that the merged THL/Apollo would have market power (which, in our view is not the case, for the reasons set out in this report and our earlier 18 February 2022 report), then the Commission would presumably decline to clear the merger anyway, on horizontal grounds.

3.2. Scale of expansion

29. A particular concern of the Commission's with respect to expansion is that the scale of expansion would not be sufficient to constrain the merged entity – see, e.g., [81] and [85] of the SOI.
30. However, as we have discussed earlier, RV capacity is fluid, and it would not be difficult to expand. While there are costs associated with purchasing motorhomes, these costs are not sunk, as motorhomes can (and are) sold at the end of their rental lives. For this reason, we think the Commission overstates the role of capital as a barrier (e.g., at [82] of the SOI).¹⁶
31. Moreover, the merged entity would be very sensitive to volume loss (for the reasons set out earlier in this report and in our 18 February 2022 report), so even a small loss of volume to rival players would be sufficient to undermine any attempted price rise by the merged entity.
32. We note also the Commission's view at [85] that, for operators with a smaller fleet:
- ...they may compete vigorously on price or service but once their fleet capacity is booked out, any constraint they pose on the merged entity falls away.*
33. This analysis is either very short-term and/or assumes that capacity cannot be adjusted within the appropriate timeframe of analysis (we note that footnote 95 of the Commission's *Mergers and Acquisitions Guidelines* refers to a timeframe of two to three years). The precise time required to expand RV capacity is a factual issue, but we have set out in this (and our earlier) report why we think RV capacity is fluid, and is likely to be adjustable within the Commission's timeframe of analysis.
34. Lastly, we note that the Commission refers to limited entry/expansion in the last ten years ([86]). It is important to frame the correct test. Difficulty in expanding when the market is competitive does not necessarily imply there would be difficulty if the merged entity raised price above the competitive level. What matters is whether providers could expand (or enter) into the provision of motorhomes if there was a (market power) price increase.

4. Coordinated effects

35. The Commission has noted (at [110]) some concerns that motorhome rentals could be vulnerable to coordinated effects. These appear to be driven by the factors listed at [111] of the SOI. We do not comment on the “interactions of motorhome rental operators through industry organisations and meetings”, as this is a factual matter. However, we can comment on the other factors listed at [111]:
- a. **“The small number of motorhome rental operators”:** This comment appears to be based on the proposition that campervans are not in the same market as motorhomes. We have set out earlier in this report why we think this is not correct. On the basis of our proposed market definition, there would be at least 12 “major” operators in the market (using the Commission's own list at [24] of the SOI), with “a degree of product differentiation and [] heterogeneity of firms in terms of size and cost structure”, as the Commission states at [112].

¹⁵As the Commission notes at [5.7] of its *Mergers and Acquisitions Guidelines*, “[a] firm is generally only able to foreclose competitors if it has market power at one or more level(s) of the supply chain.”

¹⁶ Interestingly, the Commission's *Mergers and Acquisitions Guidelines* do not list capital requirements as being a barrier to entry, although they do refer to sunk costs ([3.109.5]).

Even if the Commission determines that campervan operators are not in the same market as motorhome operators:

- i. There would still be five major motorhome rental operators “plus several smaller motorhome operators” ([24.1] of the SOI); and
 - ii. Campervan operators must surely be regarded as facing relatively low entry barriers and therefore as an entry threat.
- b. **“The visibility of price to all market participants online, the common practice of firms web scraping the prices of rivals”:** We think this statement overstates the transparency of pricing and overlooks the complexity of the distribution channels. [redacted] of THL’s rentals are transacted through distributors, with the rest being directly through THL, with [redacted] (SOI, footnote 46). We understand that the prices set by THL to distributors are not public or scrapable. They are also presumably lower than the “retail” price, to allow the distributor some margin.
- i. In effect, the extensive use of distributors (such as wholesalers and aggregators) adds many more players to the market, decreasing the ability to coordinate.

36. We also make the following comments:

- a. Unlike, say, fuel, which for consumers is generally transacted at the price when they fill their vehicle, the majority of RV rentals are transacted at a price set in advance of the actual trip. It is likely that the price for rental of a certain vehicle in a certain period varies over time leading up to that period, and that consumers transact at different times leading up to that period. This dynamic adds another degree of complexity to the market; and
- b. We have already explained why we think the barriers to expansion in the RV market are low.

37. For these reasons, we think the merger is unlikely to result in coordinated effects.

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