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COMMERCE COMMISSION

Decision No. 434

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

Caltex New Zealand Limited

and

Challenge Petroleum Limited

The Commission: M J Belgrave (Chair)
Dr M N Berry
P R Rebstock

Summary of Proposed Acquisition: Caltex New Zealand Limited or any interconnected body corporate to acquire up to 100% of the shares in Challenge Petroleum Limited.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition, subject to written undertakings as given under s 69A of the Act.

Date of Determination: 28 June 2001

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THE PROPOSAL

1 On 22 May 2001, the Commission registered a notice ("the Application") pursuant to section 66(1) of the Commerce Act 1986 ("the Act"), seeking clearance by Caltex New Zealand Limited or any of its interconnected bodies corporate to acquire up to 100% of the shares in Challenge Petroleum Limited.

2 The current proposal includes an undertaking to divest particular assets. In accordance with section 69A(3) of the Act, the undertaking is deemed to form part of any clearance given to the proposal.

THE PROCEDURES

3 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. Three extensions, of ten, two and four working days respectively, were sought by the Commission, and agreed to by the Applicant. Accordingly, a decision on the Application is required by 28 June 2001.

4 The Applicant did not seek confidentiality for any of the information contained within the Application.

5 The Commission's determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission.

6 In the course of their investigation of the proposed acquisition, Commission staff have discussed the Application with a number of parties. These parties included New Zealand's other oil companies, including Gull Petroleum Limited, the Ministry for Economic Development, the Automobile Association, Motor Trade Association, Consumers Institute, and major customers.

7 This Application was registered before amendments to the Commerce Act 1986 took effect. Accordingly this Application will be considered under the dominance threshold.

THE PARTIES

Caltex New Zealand Limited ("Caltex")

8 Caltex is a wholly owned subsidiary of Caltex Corporation, a Delaware registered company. Caltex Corporation is a joint venture company between two other US oil companies, Texaco Inc and Chevron Corporation. It has been announced that Texaco and Chevron Corporation propose to merge later this year, subject to regulatory approvals.

9 Caltex is one of the four major oil companies in New Zealand, and is involved in the importation, refining, distribution and marketing of petroleum products to Caltex branded service stations, and the provision of related goods and services. It owns sea-fed terminals situated at Mt Maunganui, Napier, Gisborne (closed), Wellington, Nelson, Dunedin and Bluff (not used).

10 Caltex has significant interests in a number of oil industry related companies. These include:

- Stars Service Stations Limited, which owns and operates Caltex company-operated service stations;
- Silver Fern Shipping Limited, which owns and operates coastal oil tankers;
- Wiri Oil Services Limited, which operates the terminal at Wiri, and supplies most of Auckland's petroleum product needs;
- New Zealand Refinery Company Limited ("NZRC"), which provides oil refining services to Caltex, BP, Shell and Mobil.

11 Of the 278 Caltex branded service stations, Caltex owns and operates 21 of these. The others are operated under commission agency arrangements or by independent dealers. It also operates approximately 117 truck stops.

Challenge Petroleum Limited ("Challenge")

12 Challenge is a wholly owned subsidiary of Rubicon Energy Limited ("Rubicon"), which in turn is a wholly owned subsidiary of Rubicon Limited, a company which was formed to hold certain assets of the Fletcher Challenge Group, including those that were not sold to Shell. Rubicon is a publicly listed company.

13 Challenge owns sea-fed bulk storage terminals at New Plymouth and Timaru. Challenge leases and operates 17 service stations, located in the North Island. It also supplies 95 branded independent dealer sites located in the North and South Islands, along with two independent distributors.

OTHER PARTIES

BP Oil New Zealand Limited ("BP")

14 BP is another of the four major oil companies operating in New Zealand, and is also involved in the importation, refining, distribution and marketing of petroleum products to BP branded service stations. It is part of the BP Amoco Group. BP owns terminals at Mt Maunganui, Napier, New Plymouth, Nelson, Lyttleton, Dunedin, and Bluff (closed). BP has also entered a joint venture with Shell in relation to its terminalling facilities at Seaview in Wellington.

15 It has a total of [ ] service stations, and [ ] diesel truck stops, [ ] of which are attached to service stations. Of its branded service stations, it owns and operates [ ], operates [ ], and [ ] are independently owned and operated.

Mobil Oil New Zealand Limited ("Mobil")

16 Mobil, another of the four major oil companies operating in New Zealand, is involved in the importation, refining, distribution and marketing of petroleum products to its branded service stations. Its parent company is ExxonMobil. It has terminals situated at Mt Maunganui, Wellington, Lyttelton, Christchurch and Bluff.

17 Mobil has a total of approximately [ ] branded stations, [ ] of which it owns and [ ] of which are owned and operated by independent dealers. It also owns [ ] diesel truck stops.

Shell New Zealand Limited ("Shell")

18 Shell is part of the Royal Dutch/Shell group of companies. It ultimately has two parent companies:

- Royal Dutch Petroleum Company, based in the Netherlands: and
- The Shell Transport and Trading Company plc, based in the United Kingdom.

19 Shell has a number of sea-fed terminals. These are situated in Auckland, Mt Maunganui and Timaru[1]. As noted above, Shell has also entered a joint venture arrangement with BP in relation to its terminalling facilities in Wellington.

20 Shell has a total of [ ] retail sites, [ ] of which are independently owned and operated and the balance being operated by agent dealers or leasees. Shell also has [ ] truck stops, [ ] of which are on retail sites.

Gull Petroleum (NZ) Limited ("Gull")

21 Gull commenced operation in Western Australia in 1976 and announced its entry into the New Zealand market in February 1998. It opened its terminal at Mt Maunganui in April 1999 and currently operates 20 sites in the North Island. Gull plans to build a network of [ ] new sites by the end of 2002, and currently has [ ] under construction.

BACKGROUND

22 All four major oil companies import both crude and refined product into New Zealand and product is refined under processing agreements with NZRC, New Zealand's oil refinery, located at Marsden Point near Whangarei. The refining process produces gasoline, diesel, aviation fuel, bitumen and other by-products. New entrants, Gull and Challenge, are also involved in the importation and distribution of petroleum products to their branded service stations, but these two companies do not have any agreement with the NZRC for the provision of refinery services and therefore import only refined petroleum products. Both Challenge and Gull deal only with diesel and gasoline products.

23 The Commission was advised that overall, New Zealand produces over 90% of its diesel needs and about 60% of its petrol needs from the refinery. Most crude product is imported from the Middle East, while most refined product comes from Singapore or from the refineries on the East Coast of Australia.

24 Product refined at the Marsden refinery is then distributed by coastal tanker to sea-fed terminals around New Zealand, or piped through the Wiri pipeline to a bulk storage terminal located at Wiri. Not all companies have tanks at each port, and companies usually have arrangements in place to store product in tanks owned by other companies. Various "borrow and loan" arrangements exist between the four main companies to draw product from each other's sea-fed terminals. Borrow and loan arrangements involve the provision to a company of refined product from another company's storage. Normally the agreement is based on a return of the volume within a defined time, at a location of the lender's choice. These arrangements may be on a permanent, temporary or emergency basis.

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[1] Based on information supplied to the Commission in 1998 by Shell et al.

25 Road tanker fleets, which may be owned either by the respective oil companies, contractors, or owner/drivers, then draw the product from the terminals and deliver it to the various retail sites.

26 In addition to the terminals owned separately by the respective companies listed above, there are also a number of jointly owned terminals, such as that at Marsden point. This is a joint venture between BP, Mobil, Shell and Caltex with each having a 25% share. Similarly, the Wiri terminal, located south of Auckland, is owned by NZRC and leased to Wiri Oil Services Limited.

MARKET DEFINITION

Introduction

27 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered, and in which the application of section 47(1) of the Act can be examined.

28 Section 3(1A) of the Act provides that:

> "... the term 'market' is a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them."

29 Relevant principles relating to market definition are set out in *Telecom v Commerce Commission* ("the AMPS A case") and in the *Business Acquisitions Guidelines*. A brief outline of the principles follows.

30 Markets are typically defined in relation to three dimensions: namely, product type, geographical extent, and functional level. A market encompasses products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit-maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

31 A properly defined market includes products which are regarded by buyers or sellers as being not too different (the product dimension), and not too far away (the geographic dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" ("ssnip"), assuming that other terms of sale remain unchanged.

32 Markets are also defined by functional level (the functional dimension). Typically, production, distribution, and sale occur through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence the functional market level affected by the application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the manufacturing market while that between wholesalers and retailers is usually known as the wholesaling market.

Identifying Relevant Markets

33 To identify the markets relevant to this Application, it is necessary to consider the business activities undertaken by the merging firms and to assess whether, post-acquisition, dominance would, or would be likely to, result or be strengthened.

34 Thus the relevant market or markets should be defined so as best to expose the competitive forces at play. As stated in the AMPS A case:

> 'The boundaries {of the market} should be drawn by reference to the conduct at issue, the terms of the relevant section or section, and the policy of the statute. Some judgment is required, bearing in mind that "market" is an instrumental concept designed to clarify the sources and potential effects of market power that may be possessed by an enterprise."

35 In respect of those activities undertaken by one or other of the firms, but not both, it may be that the competitive situation will not change by the acquisition, and in these circumstances the Commission will not usually need to identify the specific market in which the activities may fall.

The View of the Applicant

36 The Applicant in this case has contended that there are four relevant markets which are all national in scope:

- the importation, refining, and national bulk distribution and storage of petroleum products;
- the distribution and wholesale supply of petroleum products;
- the retailing and marketing of petroleum products; and
- the retailing of groceries and related merchandise.

Industry Comments

37 Commission staff sought comment upon these market definitions from major industry parties. The market players considered that the definitions proposed by the Applicant accurately reflected the products, function and geographic scope of the markets that make up the petroleum sector.

38 A general description of each market is provided below.

The Importation, Refining and National Bulk Distribution and Storage of Petroleum Products

39 This market encompasses the importation and refining of petroleum products in New Zealand. It is also appropriate to include the bulk distribution and storage elements within this market.

40 As discussed earlier, all the major oil companies import both crude oil and refined products into New Zealand, and store petroleum products at terminal facilities located at various ports around the country. Bulk product is shipped around the country from the Marsden Point refinery by the four main oil companies and is also imported by individual companies from various sources. As noted earlier, the major oil companies all have terminal facilities nationwide. Gull imports refined product into its terminal at Mt Maunganui.

41 Caltex and Challenge import refined product, which is off-loaded at port storage terminals. Caltex owns storage terminals located at Mt Maunganui, Napier, Gisborne (closed), Wellington, Nelson, Dunedin, and Bluff (not used). Challenge owns coastal bulk storage terminals at New Plymouth and Timaru. Caltex has an existing "borrow and loan agreement" with Challenge in relation to its New Plymouth terminal.

The Distribution and Wholesale Supply of Petroleum Products

42 This market is concerned with the transportation of petroleum products from the terminals to the respective branded service stations. Distribution is effected by either a company's own road tankers, or contracted transportation services, or a combination of both.

43 There are competitive road and rail transport options to transport product from terminals to retail markets.

The Retailing and Marketing of Petroleum Products

44 The Applicant has submitted that the market for the retailing and marketing of petroleum products is a national one. It points to its national network of 278 or so retail sites, and likewise, the national networks operated by its competitors BP, Mobil and Shell. It points out that all oil companies engage in marketing and promotion of their branded networks on a national basis, for example, in relation to loyalty schemes, and credit card based account systems.

45 However the Commission considers it is more likely that the markets are regional in scope. For the purposes of this Application, the Commission considers it is not necessary to define the geographic extent of the regional markets.

46 In any event, the Applicant has identified two regions, where only Caltex and Challenge operate retail sites, and where the nearest alternative supplier is at least 10kms away. If the Application were to proceed, Caltex has undertaken to divest these sites.

47 In these circumstances, the Commission considers that it is unnecessary to consider the geographic extent of these markets any further.

The Retailing of Groceries and Related Merchandise

48 The merger parties, and other oil industry players, are involved in the retailing of grocery and related merchandise through the operation of retail outlets connected to service stations. Generally, these retail outlets carry convenience products, groceries, and motoring products and accessories.

49 In relation to the retailing of groceries and related merchandise, the aggregation that is likely as a result of the proposed acquisition would be minimal, and well within the minimum level at which the Commission considers competition concerns could arise. The Commission does not propose to undertake an analysis for the purpose of accurately defining this market. The Commission notes that for the purpose of this Application only that there are a number of other competing parties in this market providing effective competition.

50 For the above reasons the Commission does not propose to assess this market further.

Conclusion on Market Definition

51 The Commission considers that the following markets are relevant for the consideration of the present proposal:

- the national market for the importation, refining, and national bulk distribution and storage of petroleum products;
- the national market for the distribution and wholesale supply of petroleum products; and
- the regional markets for the retailing and marketing of petroleum products.

COMPETITION ANALYSIS

Introduction

52 The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of dominance.

The Dominance Test

53 Section 47(1) of the Commerce Act prohibits certain business acquisitions:

> "No person shall acquire assets of a business or shares if, as a result of the acquisition, -
>
> (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
>
> (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

54 Section 3(9) of the Commerce Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has … a dominant position in a market if that person as a supplier … of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is … in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
>
> (b) The extent to which that person is … constrained by the conduct of competitors or potential competitors in that market:
>
> (c) The extent to which that person is … constrained by the conduct of suppliers or acquirers of goods or services in that market."

55 The test for dominance has been considered by the High Court. McGechan J stated:[2]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

[2] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)

56 Both McGechan J and the Court of Appeal, which approved this test,[3] stated that a lower standard than "a high degree of market control" was unacceptable.[4] The Commission has acknowledged this test:[5]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction."

57 The Commission's *Business Acquisitions Guidelines* state:

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor {or} customer reaction."
>
> …
>
> "A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability." (p21)

58 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined.

59 The Commission applies the dominance test in the following competition analysis.

The Market for the Importation, Refining, and National Bulk Distribution and Storage of Petroleum Products

Market Concentration

60 The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act -

> "In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
>
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share." (p 17)

61 Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through market entry, also typically need to be considered and assessed.

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[3] *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)
[4] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)
and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)
[5] *Business Acquisition Guidelines*, Section 7

62 The Applicant did not provide market share information for this market, but submitted that the market shares involved in the activity of importing, refining and storage are similar to the distribution and wholesale supply market shares (discussed in paragraphs 69 to 71), as shown below.

Table One

Indicative Market Shares in the Market for Importing, Refining, and National Bulk Distribution and Storage of Petroleum Products

Party	**Estimated market share (%)**
Caltex	18.9
Challenge	4.4
Combined entity	**23.3**
BP	24.8
Mobil	25.0
Shell	26.1
Gull	0.8
Total	**100**

63 In markets such as this it is difficult to precisely define market shares. The Commission notes the estimated market shares provided by the Applicant and confirmed by other industry parties. However, the Commission attaches particular weight in this Application to the level of constraint provided by existing competitors.

Existing Competition

64 Caltex submitted that the combined entity will be constrained by the presence of the other oil companies, and the implementation of the proposed acquisition will not result in the combined entity acquiring or strengthening a dominant position in the market.

65 As stated earlier Challenge has never had any product refined at NZRC, and market participants advised that the Refinery has no excess processing capacity. Post-merger it is likely that Caltex would import an increased volume of refined product, and store it in terminals around the coast. Accordingly, there will be no effect in relation to refining.

66 The Commission notes that BP, Mobil and Shell all import both crude and refined product, have crude refined at NZRC, and have petroleum products distributed and stored at various terminals facilities nationwide. Gull imports refined product into its terminal at Mt Maunganui.

67 The Commission considers that the presence of these other competitors in the market is likely to provide an effective constraint on the combined entity. Other market participants contacted by Commission staff also considered that there is strong competition in this market, and the acquisition would result in very little change, and have very little impact on the market dynamics. Industry sources advised that effective competition is likely to continue post-merger from other market participants.

68 The Commission concludes that existing market participants provide a competitive constraint at present, and are likely to continue to do so if the proposed acquisition were to be implemented.

The Market for the Distribution and Wholesale Supply of Petroleum Products

Market Concentration

69 The market shares for the distribution and wholesale supply of petroleum products have been assessed using estimated volumes supplied per annum to the New Zealand "inland" market by the six oil companies. The Applicant submitted estimations based upon its industry knowledge and experience. Market participants agreed with the Applicant's market share figures stated in the Application.

70 Table Two records the market shares in the market for the distribution and wholesale supply of petroleum products.

Table Two

Market Shares in the Market for Distribution and

Wholesale Supply of Petroleum Products

Party	Millions of Litres	Estimated market share (%)
Caltex	994	18.9
Challenge	230	4.4
Combined entity	**1224**	**23.3**
BP	1305	24.8
Mobil	1314	25.0
Shell	1371	26.1
Gull	46	0.8
Total	**5260**	**100**

71 On the basis of the above figures, the combined entity would have a market share of 23.3% with respect to petroleum products. A market share at this level will fall within the Commission's "safe harbours", as it is less than the 40% guideline.

Existing Competition

72 Shell, BP, Mobil and Gull currently provide competition to the merger parties in this market. Shell, BP and Mobil are substantial operators, with major supply and distribution operations.

73 In addition, as with the analysis of other competitors in the other markets, the Commission considers that other market participants are currently providing effective competition, and that this is likely to continue following the proposed acquisition.

The Markets for the Retailing and Marketing of Petroleum Products

Market Concentration

74 As mentioned earlier, crude oil can be refined to produce a range of petroleum products including gasoline (motor spirit) diesel, jet fuel, fuel oils, bitumen and sulphur. As Challenge only deals with gasoline and diesel products, any aggregation resulting from the proposed acquisition would only occur in these two product markets.

75 In this case, after consulting with the other oil companies competing in this market, the Commission has accepted the market share figures for gasoline and diesel provided in the Application, noting that these were sourced from the Ministry of Economic Development's records on petroleum levies and taxes for 2000. It is important to note that these volumes only relate to gasoline and diesel, and that other petroleum products, such as bitumen and aviation fuel, are not included.

76 Table Three records the market shares in the market for retailing and marketing of petroleum products.

Table Three

Market shares for the Retailing and Marketing of Gasoline and Diesel in 2000

Party	Gasoline (%)	Diesel (%)
Caltex	17.0	21.3
Challenge	4.5	4.0
Combined entity	**21.5**	**25.3**
BP	27.8	21.9
Mobil	23.1	25.5
Shell	25.9	27.0
Gull	1.7	0.3
Total	**100**	**100**

77 On the basis of the above figures, the combined entity's market share of the gasoline market would be 21.5% and of the diesel market, 25.3%. Therefore the combined entity's market share falls within the "safe harbours" discussed at paragraph 60.

Existing Competition

78 Until the entry of Challenge in April 1998, the New Zealand market was serviced by the four incumbent companies, BP, Mobil, Shell and Caltex. In 1997, ACIL Economics, Policy and Strategy Consultants ("ACIL") was commissioned to provide a report to the New Zealand Ministry of Commerce on barriers to entry to the downstream oil market. In this report, it was noted that all retail sites in New Zealand provided full attendant services, a feature that was estimated to increase retail costs by one to two cents per litre.[6] ACIL also noted that at that time, oil companies used promotions, rather than

[6] ACIL Economics & Policy Report to the New Zealand Ministry of Commerce, *Barriers to the Entry to the New Zealand Downstream Oil Market*, August 1997, p 25.

price, to compete. The explanation given for this was that because they used the same refinery and coastal ships, the four existing companies had similar cost structures (and therefore charged similar prices to each other). Therefore, costs did not provide a competitive advantage to any one of the four major companies, and discouraged each of them from using price to gain market share. [7]

79 Since then, industry observers have noted that with the entry of Challenge and Gull, the nature of competition has changed. Instead of competing on aspects such as service (full attendant services are no longer predominant, and self-service is now common at all retail sites in New Zealand), carwashes and promotions, competition is now focussed strongly on price. Mr Bob Constantine, CEO of Challenge, stated that when Challenge entered the market in April 1998, it simultaneously opened 8 - 10 sites all around the North Island (except in the Napier/ Hastings area), and set its prices five cents lower than the market rate. The majors responded by dropping prices to the same level as Challenge.

80 Mr Constantine contends that Challenge's presence in the market not only resulted in this initial price reduction but has also had the long term effect of keeping margins lower than they otherwise would have been. Mr Constantine argues that not only have the majors been slower to put price increases in place, but also that those increases were lower than would have otherwise been the case. Such an assertion, of course, is difficult to test, but the overall trend for margins in this market is discussed below in paragraphs 86 to 88.

81 A representative of the Automobile Association ("AA") commented that the effect of Challenge on price competition in the retail petroleum product market now appears to have waned. According to records kept by AA, there have been around 50 price movements, either up or down, in the last two years, (excluding the 10 cent one-day specials which occurred twice in December 2000, and once each in February, March and April 2001). Of these 50 or so movements, about 20 have been down.

82 Of the other downward moves, 10 have been attributed to BP, five to Shell, one to Mobil, one to Caltex, and one to Caltex/BP. Challenge and BP have been jointly attributed as leading only two of these downward moves. This analysis provides support to the contention that Challenge's influence in leading prices down (when market conditions permit) has diminished significantly.

83 Gull entered the retail market in November 1999, building a terminal at Mt Maunganui. Gull now has a network of 20 sites in the North Island (two of which are for wholesale supply only), which are situated in Auckland, Tauranga, Hamilton, Palmerston North and New Plymouth. It intends to establish a network of [ ] sites in the North Island over the next [ ] months and has [ ] sites actively under construction.

84 In the regions where Gull has opened its sites, the retail market for petroleum products has been characterised by intense price competition, especially in Tauranga. One industry observer has commented that Gull now appears to be taking the place of Challenge in promoting price competition in the retail petrol market.

85 An interesting development in price competition over the last six months or so is the 10 cent reductions, which on four of five occasions, were instigated by Shell. These special promotions usually last for one or two days only and the other oil companies have reacted quickly, either by matching or in one case, increasing, the size of the reduction.

[7] Ibid, p 25.

This is a new form of price competition that is being instigated by the major oil companies, and does not appear to be in response to any initiatives by Gull or Challenge.

86 According to the Ministry of Economic Development ("MED") figures, there has been a continuing downward pressure on margins over the last five years. MED uses Singapore bulk (for loading tankers) prices for petrol and diesel as benchmarks for monitoring the New Zealand pump prices for these products. As published in the MED's Energy Data File analysis for January 2001,[8] the trend is for margins to have reduced by around 2.5 - 2.8 cents per litre per year since the second quarter of 1996.

87 Ministry sources have attributed this steady decrease in margins as evidence of a much greater level of competition since Challenge and Gull entered the market. It has been pointed out that the beginning of the downward trend, starting in 1996, coincided with market knowledge that entry by such companies as Challenge, Liberty and Gull was likely or imminent. The Commission also notes there are several other factors that may also have contributed to this trend for margins to decrease, including a fall in the value of the New Zealand dollar over much of this period.

88 MED has confirmed that in real terms, during the first quarter of 2001, the retail importer margin for regular petrol fell to its lowest recorded[9] level of 11.7 cents per litre. The retail importer margin is the margin available to cover domestic transportation, distribution and retailing costs as well as wholesalers' and retailers' marketing margins.

89 A representative of the Motor Trade Association, which represents garage and service station owners throughout the country, stated that retail margins for independent service station owners are very slim at present, and that this market is operating at an extremely competitive level. As a result, the number of independent retail sites has significantly declined over the last ten years, and the respective oil companies now own or control 75% of all service stations in New Zealand.

90 All industry participants spoken to during the investigation stated that there was an intense level of competition in this market, and they do not anticipate that the proposed merger will have a significant impact on the level of competition.

91 The Consumers' Institute advised it was opposed to the proposed acquisition. The Institute stated that Challenge's entry into the market resulted in lower fuel prices and therefore submitted the proposed acquisition may result in a lessening of price competition. However as stated above, the Commission considers Challenge's influence in leading prices down has diminished significantly, and Gull now appears to be taking the place of Challenge in promoting price competition.

92 The Commission considers that the other oil companies provide a competitive constraint at present, and are likely to continue to do so if the proposed acquisition were implemented. As stated earlier (paragraphs 53-57), dominance relates to market power and involves the unilateral ability of a firm to make decisions on output and pricing largely unconstrained by potential responses of other market participants.

93 The Commission is satisfied that the constraint by the other oil companies would prevent the combined entity from acquiring or strengthening a dominant position in the market.

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[8] New Zealand Energy Data File January 2001, Energy Modelling and Statistics Unit, Energy Markets Information and Services Group, Resources and Networks Branch, Ministry of Economic Development.

[9] MED's records on these products began in 1983. MED's analysis excludes margins from the fourth quarter of 1989 to the second quarter of 1991, removing a period of volatility in margins as a result of the Gulf War.

OVERALL CONCLUSION

94 The Commission has considered the impact of the proposed acquisition in the following markets:

- the national market for the importation, refining and national bulk distribution and storage of petroleum products;
- the national market for the distribution and wholesale supply of petroleum products; and
- the regional markets for the retailing and marketing of petroleum products.

95 The Commission has also considered the impact of the proposed acquisition in the market for the retailing of groceries and related merchandise.

96 Having regard to the factors set out in section 3(9) of the Commerce Act, and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

DETERMINATION ON NOTICE OF CLEARANCE

97 Accordingly, pursuant to section 66(3) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Caltex New Zealand, or any interconnected body corporate, of up to 100% of the shares in Challenge Petroleum Limited, subject to the terms of the divestment undertaking attached as Annexure A.

Dated this 28th day of June 2001

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M J Belgrave
Chair

ADDENDUM

Paragraph 90 of this Decision has been amended to read as follows;

> "All industry participants stated that there is an intense level of competition in this market. With the exception of Gull, they do not anticipate that the proposed merger will have a significant impact on the level of competition in this market. Gull expressed concern that its future potential to compete in this market would be impeded with the removal of Challenge."

Dated: 6 July 2001