Public Version
ISSN NO. 0114-2720
J5363

COMMERCE COMMISSION

Decision No 467

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

RED BUS LIMITED

and

LEOPARD COACHLINES LIMITED

The Commission:	MJ Belgrave D Bates QC P JM Taylor
Summary of Application:	The acquisition by Red Bus Limited of the business of Leopard Coachlines Limited, being the business of operating certain urban bus routes operated by Leopard. The assets of the business, as set out in the Sale and Purchase Agreement are the contracts for operation of the bus routes, the buses themselves, goodwill, plant and equipment.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to decline clearance for the proposed acquisition.
Date of Determination:	30 July 2002

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THE PROPOSAL

1. On 28 June 2002, Red Bus Limited ("Red Bus") registered a notice with the Commerce Commission ("the Commission") seeking clearance under s 66(1) of the Commerce Act 1986 ("the Act") to acquire the business of Leopard Coachlines Limited ("Leopard"), being the business of operating urban bus routes, as described in the Agreement for Sale and Purchase. The main assets of the business are the contracts for the operation of the bus routes and the "Buses" as described in the Agreement for Sale and Purchase. The balance of the assets comprises goodwill and various plant and equipment.

THE PROCEDURES

2. 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 notice agree to a longer period. Extensions of time were sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 30 July 2002.

3. In its application, Red Bus sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's determination is based on an investigation conducted by staff.

5. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

Red Bus

6. Red Bus operates various bus routes in Christchurch and surrounding areas under contracts granted by Environment Canterbury (the Canterbury District Council) together with various commercial (non subsidised) bus routes.

7. Red Bus is the wholly owned subsidiary of Christchurch City Holdings Limited (CCHL). CCHL is a local authority trading entity owned by the Christchurch City Council (CCC).

8. Other companies in which CCHL owns shares are:

   - Orion Group Limited (energy)
   - Lyttelton Port Company Limited
   - Christchurch International Airport Limited.

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[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

9. CCC owns shares in a number of companies.

10. Red Bus owns CTL Properties Limited.

Leopard

11. Leopard operates various bus routes in the Christchurch area under contracts granted by Environment Canterbury, plus other bus operations such as school bus contracts, bus charters, ski field operations and inbound tourism coach operations.

12. Leopard entered the urban bus market in 1995 as the situation in the tourism market had deteriorated because of the Asian crisis.

13. Leopard is owned by a group of private investors:

    - One of these, Brent Early, has an interest in Top Coach Limited, a tourism based business operating nationwide.

    - Another, Rainer Heidtke also has interests in several tourism related businesses.

14. In the application, Leopard indicates it wishes to cease operating urban bus routes in order to focus entirely on the tourism market.

OTHER RELEVANT PARTIES

Canterbury Regional Council (Environment Canterbury)

15. Environment Canterbury is constituted under the Local Government Act 1974. As part of Environment Canterbury's function to provide services on behalf of central Government, it is responsible for public passenger transport planning, and providing subsidies for passenger transport services. Environment Canterbury compiles a Regional Passenger Transport Plan, which specifies the services it proposes for the region. It then accepts commercial registrations for bus services, and invites tenders for subsidised services. Environment Canterbury receives about 50% of its funding for the subsidised bus transport services from rates and the balance from Transfund.

Transfund New Zealand

16. Transfund New Zealand ("Transfund"), a crown entity established by the Transit New Zealand Amendment Act 1995, is responsible for the funding of the land transport system formerly undertaken by Transit New Zealand. This involves allocating road-user funds from the National Road Account on the basis of the applications for project funding from Transit New Zealand, territorial authorities and regional councils.

17. Transfund also has the responsibility for approving competitive pricing procedures ("CPPs"), which regional councils are required to use when conducting tenders for the supply of subsidised public passenger services. The basis on which CPPs will be approved is contained within the Transit Act 1989.

Bus and Coach Association

18. The Bus & Coach Association (NZ) Inc. was first established in 1931 and has operated under various names since that time. The Bus & Coach Association (NZ) is the voice of

the New Zealand bus and coach industry. It is an industry association that covers bus and coach operators as well as other businesses associated with the industry, including coach and equipment and service suppliers.

19. Funded by subscriptions from voluntary members, the Bus & Coach Association represents all the major and most of the smaller bus companies in New Zealand, or about 75% (360) of all operators with about 80% (4,400) of the commercial bus fleet.

20. The Association's work includes representing the industry on school transport matters, urban issues, tourism, and limousine, which comprise the Association's four sector groups. The Association acts as the industry's voice to central and local government, related bodies and the media on relevant issues, writing submissions and publishing fact sheets on relevant subjects.

Other Bus and Coach Operators

21. Other bus operators who are or who have recently been involved to some extent in the Canterbury region are:
    - Ritchies Transport Holdings Limited ("Ritchies")
    - Invergargill Passenger Transport ("IPT")
    - Cityline Buses
    - Emanen
    - Geraldine Transport Services.

INDUSTRY BACKGROUND

Transport in Christchurch

22. The Christchurch bus service market is less developed than in Wellington or Auckland. Only 4% of the Christchurch population take the bus every day, compared with 7.3% in Auckland and 15.5 % in Wellington.

23. As car parks are readily available and cheap compared to the other main centres, most people travel by car with a low occupancy rate per car (about 1.03).

24. Unlike Wellington, there are hardly any topographic corridors, so that the traffic is more spread out and congestion, if at all, only occurs on the main trunks in the City Centre. However Environment Canterbury expects the traffic to grow at least 43% over the next 20 years and congestion to increase on a number of streets.

25. The Christchurch bus market is experiencing patronage growth. A doubling of the 1997/1998 passenger numbers to 18 million is forecast by June 2007 in Christchurch.

26. Bus is the only public transport available in Christchurch as there are no commuter trains. There is the Diamond Harbour Ferry operating in Lyttelton Harbour.

Regulatory Environment

27. Before July 1991, operators of public transport services held an exclusive licence to operate in their respective areas. This protection was removed by the Transport Services Licensing Act 1989 (the TSL Act).

28. Nonetheless, the operation of local bus passenger services continues to be regulated by three pieces of legislation, the main provisions of which are outlined below.

Transport Services Licensing Act 1989

29. Under the TSL Act, a licence to operate bus services may be granted to any person who does not have a criminal record, or any major convictions under the Transport Act, and who can demonstrate familiarity with the relevant legal requirements.

30. The TSL Act specifies that a licence holder who proposes to operate a commercial service must register that service with the appropriate regional council. The grounds on which a regional council can decline registration, set out in s 50(5) of the Act, are if the proposed service:

    a) is likely to have a material adverse effect on the financial viability of any contracted services;

    b) is likely to raise the net cost to a regional council of any contracted service; and

    c) is contrary to sound traffic management or any environmental factor identified by the regional council as being of importance to the region.

31. The TSL Act stipulates that, before a regional council can provide funding for public passenger services, it must produce a Regional Passenger Transport Plan ("RPTP"). The RPTP, which sets out the means for implementing the Regional Land Transport Strategy (see below), specifies the routes, frequencies and hours of operation that the regional council is prepared to subsidise.

Transit New Zealand Act 1989 and the 1995 Amendment

32. The Transit New Zealand Act 1989 ("the Transit Act") established a Government agency responsible for planning national passenger transport, and for allocating Government funds to regional councils for subsidised passenger services. The Transit Act also specified that funds should be allocated only to those subsidised services that have been subject to an appropriate Competitive Pricing Procedure ("CPP"). CPPs provide the rules under which the tendering process for subsidised services are conducted. Specifically, they contain provisions relating to contract duration, process, the maximum size of a contract, and concessionary fare schemes. CPPs are designed to ensure competition for tenders, and that the lowest price is paid, subject to minimum quality and safety standards.

33. The Transit New Zealand Amendment Act 1995 established a new funding agency, Transfund, to carry out the funding role previously undertaken by Transit New Zealand. As part of Transfund's role, it must approve CPPs for subsidised services. Pursuant to s 26(3) of the Transit Act, in approving CPPs the Transfund Board must have regard to the following factors:

    (a) the efficient application of the State Highways Account and Land Transport Disbursement Accounts;

    (b) the safety and other interests of the public in respect of the output or capital project or the class of output or capital project;

    (c) the desirability of encouraging competition in the sector of industry likely to supply goods or services in relation to the output or capital project or the class of output or capital project;

(d) the undesirability of excluding from competition for the output or capital project or the class of output or capital project any party who might otherwise be willing and able to compete; and

(e) the cost of administration associated with the pricing procedure or of any contract formed under that procedure.

The Land Transport Act 1993

34. Under the Land Transport Act 1993, each regional council is required to produce a Regional Land Transport Strategy. This document identifies the land transport needs of the region, the most desirable means of responding to such needs, and an appropriate role for each transport mode in the region.

Commercial and Subsidised Services in Christchurch

35. Broadly, there are two sources of funds to support passenger transport services in Christchurch – subsidies and fare receipts. These support two types of service:

- Contracted services are partly subsidised through grants from Environment Canterbury. Subsidies are paid using funds collected from local body rates, and from Transfund. Until recently, Environment Canterbury contributed 60% of the subsidy, and Transfund provided the balance. Environment Canterbury joined the new funding mechanism Patronage Funding Scheme, which has affected the balance of subsidy paid by Environment Canterbury. Contracted services also draw fare revenues, although Environment Canterbury fixes the maximum fare allowed.
- Commercial services rely entirely on fare receipts and do not get any subsidies from Environment Canterbury.

Contracted (Subsidised) Services

36. To satisfy CPP requirements, a competitive tender process determines who is to operate each contracted service. Like other councils, Environment Canterbury is required to invite operators to submit tenders to supply particular services that are not provided on a commercial basis. The tender documents specify, among other things, the service requirements, a maximum fare schedule, the length of the contracts, and minimum vehicle standards. Environment Canterbury organises its tendering round on an annual staggered basis, currently every six months but it is looking at moving towards yearly tendering rounds.

Tender evaluation process

37. Each tenderer submits two envelopes:

- Envelope A, which describes the supplier's attributes:
    - Relevant experience;
    - Track record (operator's past performance such as courtesy, presentation of vehicles, promotion of services, level of customers' complaints, past ability to adhere to contractual requirements and reliability);
    - Management and Technical skills (staff expertise, staff training, staff motivation, quality management processes and effective preventative maintenance programme); and

- Resourcing Programme (age and quality of vehicles, availability of appropriate depot facilities for both staff and vehicles.

- Envelope B, which contains the tender amount (amount of subsidy required).

38. Suppliers' attributes are incorporated in the tender process through the inclusion of minimum standards and adjustments to the tender price (subsidy submitted in Envelope B) using the quality/price trade-off method:
    - The specification of minimum standards is intended to ensure that all eligible tenderers have at least the minimum abilities or resources necessary to fulfil the contract.
    - The quality/price trade-off method is used to adjust the rankings based on prices from Envelope B to reflect the supplier quality above the minimum requirements. The Council's evaluation of operator quality and the Council's willingness to pay a premium for that quality are assessed prior to opening Envelope B containing the tender amounts. The assessment of suppliers' attributes are contract specific and may vary depending upon the nature of the service tendered. These are specified in the Request for Tender documentation. The suppliers' attributes are scored out of a total of 100 points.

39. At the end of the process, Environment Canterbury publishes:
    - the total number of bidders;
    - the name of the successful bidder;
    - the quality-adjusted price (subsidy) that won the tender;
    - the highest bid; and
    - the lowest bid.

40. Environment Canterbury has the ability to negotiate the price submitted in Envelope B only if there was one tenderer. It can also re-tender the contract if it is not satisfied with this tenderer.

Fares and subsidies

41. The tender amount put in Envelope B is the subsidy asked for by the bidders to be able to run the service. The subsidy is determined by the formula:

    SUBSIDY= Costs of running the service – (Fare * Patronage).

42. The fare is fixed by Environment Canterbury and cannot be changed without Environment Canterbury's agreement.

43. There was one fare increase in 1999 initiated by Environment Canterbury to decrease the bus loading time. The fare went up from $1.80 to $2 (the "gold coin").

44. Environment Canterbury's approach is that operators can recoup increased operating costs on a route by increasing the subsidy they ask for the next time the route is tendered. However, operators are covered by a provision in the contracts allowing them to ask for more subsidies before the term of a contract if costs have increased greatly.

45. Environment Canterbury initiated a review of the fare and ticketing system in the Christchurch metropolitan area last year. This review has been carried out in consultation with the public and the operators. Even though it will lead to an increase in fares in certain cases and a decrease in others, it is claimed not to be a revenue driven review.

Environment Canterbury is aiming at integrating the whole network by implementing an Integrated Ticketing System and making fares consistent across the whole network.

Bus requirements

46. Environment Canterbury specifies in the tender documents and contracts the nature of the buses required for operating each service. It usually requires super low floor buses for non-peak runs and conventional buses for peak time that will operate in addition to the super low floor buses. Out of a total number of 165 buses operating on routes that have peak and off peak runs, there are 117 super low floor buses (71%). Environment Canterbury wishes to increase this percentage and have [ ] of super low floor buses during inter peak.

47. Super low floor buses cost about $250,000, plus $10,000 for a new ticketing machine.

48. As part of its investigation, the Commission considered whether availability of buses could be a limiting factor for some bus operators. Its inquiries indicated that bidders did not have to own the super low floor buses at the time they bid. An accompanying letter from a bus builder certifying that they would build the new super low floor buses required by the start of the contract is sufficient.

49. Environment Canterbury allows about four months for the successful bidder to build up its fleet and start the contract, allowing time for buses to be built.

50. Designline, a New Zealand builder of buses and coaches established in Ashburton builds about [ ] of the super low floor buses in New Zealand. It doubled the capacity of its factory last November, meaning that it is able to meet the orders placed by bidders.

51. Designline explained that it usually met with the tenderers before they put a bid in to discuss the tendering process and the bus requirements. Once Environment Canterbury has awarded the contract, it has to order the bus parts from overseas. It takes about three months to get them and then 16 days to build one bus. By the end of a four-month period including the ordering and delivering time of the pieces, it could deliver about 14 buses.

52. The Commission understands that the market for conventional buses is very tight. With the kick-start funding system that has been in place for the last three years, Regional Councils have been encouraged to put new services in. It is therefore hard at the moment to find second hand conventional buses in New Zealand. However, they could be imported from overseas and re-built to comply with the New Zealand vehicle quality standards.

53. Environment Canterbury said that [

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Operation and monitoring of contracts

54. The successful bidder must operate the subsidised service(s) in accordance with the conditions specified in the tender documents. Failure to comply with the terms can lead to penalties being imposed, and in extreme instances, to the cancellation of the contract.

55. Environment Canterbury monitors compliance with the contracts by using the following means:

- Monitoring complaints;
- Monitoring the bus exchange and real time information system;
- Inspecting vehicles every quarter;

- Monitoring the accident and complaints register;
- Monitoring patronage by taking copies of bus sales;
- Monitoring compliance with time schedules (fine of $1,500 if the bus is 15 minutes late); and
- On bus monitoring.

Commercial Services

56. Commercial services can be registered at any time, on any route, and to any timetable, subject to the provisions of the Transport Services Licensing Act.
57. If Environment Canterbury were dissatisfied with the commercial service provided, it could invite tenders from bus companies to operate a similar subsidised service (i.e., it could "contract over" an existing commercial service).
58. There is a significant difference between the Auckland and Canterbury Regional Councils' approach to registration of commercial services. The Auckland Regional Council adopts a more liberal approach than Environment Canterbury to permitting bus operators to notify commercial (non-subsidised) urban bus routes pursuant to the Transport Services Licensing Act.
59. In Policy 5.1 of its Regional Passenger Transport Plan 2001, Environment Canterbury states that:

    "Contracted services will be offered to operators as a complete package of morning and afternoon peaks as well as off peak periods and week-ends."

    "Service contracts will not be unbundled into parts of the day, although a combination of services combining routes may be offered. This policy supports Policy 4.7, which provides for a uniform pricing system. Fares are set on the basis of overall cost recovery aims. This inherently involves a lower subsidisation of the peak relative to the off peak.

    This policy will make the commercial registration of a partial service for only parts of a day (e.g. morning and/or afternoon peak periods) unlikely to be acceptable. Accepting commercial registration for only a part of a day would make the remaining residual parts less attractive to other prospective contractors and jeopardise overall cost recovery goals. Commercial registrations of whole service contracts will still be acceptable."

60. In other words, Environment Canterbury will not permit the "cherry-picking" of commercial routes. Environment Canterbury's policy is that it will not permit operators to notify commercial routes for selected (peak) time slots during a day and that any such notification must be for the whole day. This has limited the ability of operators to notify commercial routes in the Christchurch market.
61. Therefore, the Christchurch market is overwhelmingly composed of subsidised routes, which are stringently and actively controlled by Environment Canterbury.
62. There are currently only four commercial services in Christchurch, including the service from the Airport. These have always been commercial and apart from the Airport Service, which costs $4, their fares are all within Environment Canterbury's fares schedule.

63. Unlike Wellington and Auckland where commercial services are partly subsidised by the Regional Council through the concessionary fare scheme, commercial services in Christchurch do not get any subsidies from Environment Canterbury.

64. Environment Canterbury and the operators said that the subsidised services run in Christchurch would not be viable as commercial services.

Patronage Funding

65. Until recently, central Government support for passenger transport services has been based on subsidising a fixed percentage of the net costs borne by regional councils for their local passenger services (bus, rail and ferry). This subsidy had been capped at $36.6 million (GST exclusive) nationally and was paid irrespective of the number of passengers carried.

66. The new funding mechanism, known as "patronage funding", is based on passengers carried, and hence provides councils with higher funding for increased patronage. From 1 November 2000 regional councils have been able to join the Patronage Funding Scheme. Transfund is also offering Kick-Start funding, which provides up-front assistance for councils wishing to establish new services, or to undertake other initiatives. From July 2003, only patronage funding will be available.

67. Patronage funding applies to changes in patronage from a baseline agreed at the date each regional council joins the scheme. This baseline generally relates to passengers carried during the previous year. No council will initially receive less funding than it had received under the present method. So if current patronage levels were to remain unchanged or to fall, a council would still receive the current funding.

68. Payment rates per additional passenger carried will be higher than the baseline rate. These rates will be on a two-tier basis - a peak rate, specific to each region, for patronage at peak times (reflecting the benefits of relieving traffic congestion), and an off-peak rate at other times (reflecting all-day benefits such as those to passengers, safety, and the environment). The differing rates in each region are proportional to the variation in regional congestion levels. For example, Auckland, with the highest levels of congestion, will attract the highest peak rate.

69. The scheme is a fundamental change from the previous scheme, because it is focussed on encouraging councils to induce more people to use public transport, rather than just funding a proportion of costs with no relationship to patronage. In essence, the scheme is performance-based, instead of subsidy-based, and is designed to encourage councils to look at ways to increase patronage.

70. Patronage funding payments go to regional councils, not direct to operators. Passengers on both commercial and contracted passenger services attract patronage funding for the regional council from Transfund. The same payment rates apply to passengers irrespective of the travel mode they use (bus, rail or ferry).

Recent Cases

Decision 318: New Zealand Bus Limited/Transportation Auckland Corporation Limited

71. On 12 December 1997, the Commission received an application from NZBL seeking clearance to acquire Transportation Auckland Corporation Limited ("TACL"). The application was assessed under the dominance test.

72. The relevant markets were defined as follows:
    - the provision of scheduled bus passenger services in the greater Auckland metropolitan region;
    - the provision of school bus services in the greater Auckland metropolitan region; and
    - the provision of bus charter services in the greater Auckland metropolitan region.
73. The Commission found that in the market for the provision of scheduled bus passenger services the merged entity would have a very high market share, around [ ]% and would not face constraint from existing competitors. The Commission also found that barriers to entry were high, and new entry was unlikely. The Commission recognised the Auckland Regional Council exercised some countervailing power, but was not satisfied it was sufficient to constraint NZBL from acquiring dominance.
74. On 24 February 1998 the Commission declined to give clearance for the proposed acquisition.

Decision 326: NZBL/TACL

75. On 2 April 1998 the Commission received an application from NZBL seeking authorisation to acquire TACL. This was again assessed under the dominance threshold.
76. The relevant markets were defined as follows:
    - the provision of scheduled bus passenger services in the greater Auckland metropolitan region; and
    - the rights to operate commercial and subsidised scheduled bus passenger services in the greater Auckland metropolitan region.
77. The Commission again found that existing and potential competition were not sufficient to prevent dominance being acquired. However, on the basis of new evidence, the Commission accepted that the countervailing power of Auckland Regional Council would provide effective constraint on the merged entity. Given the Commission was satisfied dominance had not been acquired, it was not required to conduct a public benefit and detriment test (which constituted the second part of an authorisation).
78. On 15 May 1998 the Commission gave clearance for the proposed acquisition.

Decision 460: New Zealand Bus Limited and Wellington Regional Rail Limited/Tranz Metro (Wellington).

79. On 23 November 2001, New Zealand Bus Limited ("NZBL") registered a notice with the Commerce Commission ("the Commission") seeking clearance under s 66(1) of the Commerce Act 1986 to acquire a 50% interest in a company to be established, probably to be known as Wellington Regional Rail Limited ("WRRL"). Wellington Regional Council ("WRC") will own the other 50% interest (through WRC Holdings Ltd). The joint venture company will, in turn, acquire 100% of the assets of Tranz Metro (Wellington) ("Tranz Metro").
80. On 19 December 2001, pursuant to s 68(2) of the Commerce Act 1986, the Commission determined to decline clearance for the proposed acquisition, on the basis the proposed acquisition was unlikely to be proceeded with.[2]

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[2] References to sections will be to sections of the Commerce Act 1986 unless specified otherwise.

81. The applicant appealed this decision to the High Court. The High Court ruled in favour of the appellant and ordered the Commission to reconsider the application.

82. The relevant markets were defined as follows:

- the market for the rights to operate scheduled passenger rail services in the greater Wellington area ("the rail tendering market");
- the market for the provision of scheduled passenger rail services in the greater Wellington area ("the rail services market");
- the market for the rights to operate scheduled bus passenger services in the greater Wellington area ("the bus tendering market"); and
- the market for the scheduled bus passenger services in the greater Wellington area ("the bus services market").

83. The Commission was concerned that the involvement of the WRC as co-owner of the rail network with NZ Bus might weaken the countervailing power exercised by the regional council as funder and as relied upon by the Commission in Decision 326.

84. The Commission noted that there is minimal competition from other operators in the Wellington tendered bus market. It also considered that there are substantial entry barriers to the market.

85. However, the Commission concluded that that under the proposed arrangements, WRC's ability and incentive to alter the constraints on NZ Bus would not change. In addition, the minimal competitive constraints on NZ Bus in the bus tendering market would be no different under the counterfactual. The Commission therefore decided that there would not be a substantial lessening of competition in the bus tendering market.

86. On 10 April 2002, the Commission cleared NZ Bus to purchase a 50% interest in a joint venture with the Wellington Regional Council, where the joint venture would in turn buy the assets of the Wellington urban rail service, Tranz Metro (Wellington).

MARKET DEFINITION

87. The Act defines a **market** as:

> . . . 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.

88. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

89. It is substitutability at competitive market prices that is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

90. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:
    - the goods or services supplied and purchased (the product dimension);
    - the level in the production or distribution chain (the functional level);
    - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
    - the temporal dimension of the market, if relevant (the timeframe).

91. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

92. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

93. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

94. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future[3]. The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

Demand-side substitution

95. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

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[3] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

96. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

97. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

Supply-side substitution

98. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

Undifferentiated/Differentiated Products

99. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

100. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

Relevant markets

101. The applicant has proposed the following market definition: "the operation of urban bus routes within the territorial jurisdiction of Environment Canterbury (thus covering both Christchurch and Timaru)".

102. The Commission has considered bus transport markets previously in Decisions 318, 326 and 460. In Decision 460, the Commission defined the following bus markets:

- the market for the rights to operate scheduled bus passenger services in the greater Wellington area ("the bus tendering market"); and

- the market for the scheduled bus passenger services in the greater Wellington area ("the bus services market").

103. The distinction between tendering for subsidies and bus services recognises that the market for the right to ply routes and the market for passenger trips are separate and not completely integrated. The subsidies and services markets are subject to entirely different levels of competition. In general, there is no competition in the bus services market: a bus trip at one time of day between two places is not generally substitutable for the same trip at another time or a bus trip that follows a different route. On the other hand, in the subsidies market, there is a single local buyer of services and several competing suppliers. These suppliers regard various route contracts as substitutes, to some degree.

104. "The bus tendering market" and "the bus services market" are generalisations. In fact, the bus services market consists of a large number of individual routes travelled at different times throughout the day. Because a significant number of passengers do not consider these services to be close substitutes, the Commission would normally regard each route as a separate market. However, because route markets are similar and because the consequences of the present acquisition for each route are similar, the present analysis treats the bus services market as if it were a single market. Similarly, the bus subsidies market is not homogenous, since each contract is specified differently and has a different commercial value, however it is the total competitive effect of the proposed acquisition that is the subject of the present analysis.

105. In previous decisions, alternative modes of transport were excluded from the bus transport market definitions. (The exception was Decision 460 where rail markets were defined, since the proposed joint venture was for a rail operation. However, the analysis in that decision also assumed that bus and rail markets were separate.) Table 1 in Decision 326 (reproduced as table 1 in Decision 460) provides the Commission's reasons why cars, taxis, rail services, ferries and other modes are excluded from the market definition when considering the acquisition considered therein. Essentially, other modes are excluded either because they provide dissimilar transport or because they provide similar transport but at a much greater relative cost.

106. While there may be a fair degree of supply-side substitutability in both the bus services and bus subsidies markets, there is little demand-side substitutability in either market. On the supply side, bus operators may regard different routes and different tenders for routes as being close substitutes (depending upon the returns they provide) and can switch production between different routes and tenders. Passengers do not, however, regard different bus routes as substitutes (as mentioned above) and Environment Canterbury does not regard different tenders as substitutes. Environment Canterbury's objective is to provide an integrated network of bus services to its constituency. Therefore, from its perspective, each part of the network (including services on different routes and at different times) are complementary to each other service and to the whole.

Geographic Extent

107. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until

the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

108. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

109. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.

110. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

111. The Commerce Act defines a market to be a "market in New Zealand". However, in many markets New Zealand buyers purchase products from both domestic and from overseas suppliers. Where imported products are close substitutes for domestic products, the overseas suppliers will be part of the relevant market. In such circumstances the Commission, in order to comply with the wording of the Act, is likely to define a national market and then, as discussed later in the competition analysis, to consider the extent to which overseas suppliers exercise a competitive constraint on the participants in the domestic market.

112. The applicant suggests a market definition that includes Timaru. It is the Commission's view that large-scale operations in either Timaru or Christchurch would likely require depot facilities in each location. However, the Commission recognises that operations in Timaru are minor compared to those in Christchurch. The network economies available to operators who provide services on close routes in Christchurch are unlikely to be available between routes in Timaru and Christchurch. Specifically, operators could not efficiently use the same bus to provide services both on routes in Christchurch and in Timaru on the same day. On the other hand, operators can switch buses between routes that are close, thus avoiding idle time.

113. Thus, though the Commission accepts that the bus subsidies market extends to all of "the territorial jurisdiction of Environment Canterbury (thus covering both Christchurch and Timaru)", it also recognises that there are market segments, with the Christchurch urban area representing a distinct segment from the Timaru segments. The geography of the bus services market is defined by its individual routes.

Functional Level

114. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one

horizontal level, but not others.4 Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

115. The applicant's proposed market definition did not distinguish between a bus services market and a bus subsidies market, however it has been the practice of the Commission to assume that this distinction is real and that it matters, for the reasons given earlier.

116. The functional distinction between the market for bus services and the market for bus subsidies is that the commodity traded (i.e., access rights) in the subsidies market is an input to the supply of trips in the services market.

Conclusion on Market Definition

117. The Commission concludes that the relevant markets are the following:

1. the market for the rights to operate scheduled, subsidised bus passenger services in Christchurch and Timaru ("the bus subsidies market"); and

2. the market for the scheduled bus passenger services in Christchurch and Timaru ("the bus services market").

COMPETITION ANALYSIS

Substantially Lessening Competition

118. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

119. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[5] What is required is a real lessening of competition that is not minimal. The

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4 *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

[5] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

lessening needs to be of such size, character and importance to make it worthy of consideration.[6]

120. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[7]

121. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.[8]

122. In interpreting the phrase "substantially lessening competition", the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

> Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

> This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

123. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

124. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable

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[6] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [ ] 1 All ER 289.

[7] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

[8] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

125. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

126. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[9]

Leopard's decision to exit the market

127. Leopard said that it was committed to exiting the market [ ]

128. [ ]

129. [ ]

Acquisition of Leopard by a third party

130. [ ] said they would be interested in buying Leopard's urban business if it came onto the market for sale provided the financial figures were good and the price was not too high.

131. [ ] said that it would have a look at Leopard if it came onto the market but [ ].

132. [ ] It could not say whether it would be interested in Leopard or not.

[9] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

133. Furthermore, Red Bus claimed that, by selling its urban runs to Red Bus, Leopard would ensure continuity in the services it provides. However, the Commission considers that this is would be the case no matter who bought the contracts.

Further submissions from Red Bus and Leopard on the counterfactual

134. In further submissions to the Commission, Red Bus and Leopard commented on the counterfactual the Commission proposed to use for the acquisition. This counterfactual was the situation where the relevant assets of Leopard were bought by a third party. Red Bus and Leopard's arguments against the proposed counterfactual and the Commission's responses are listed in Table 1.

Table 1: Red Bus and Leopard submissions against the Commission's proposed counterfactual and the Commission's responses

Red Bus and Leopard arguments against the Commission's proposed counterfactual (Leopard acquired by a third party)	**The Commission's responses**
It is a theoretical and highly improbable scenario to judge the proposed transaction against the Commission's proposed counterfactual.	Leopard claims that its urban bus operations are profitable and on that basis the Commission considers it reasonable to assume that Leopard would prefer to sell the routes rather than walk away from them. Furthermore some parties [ ] have shown some interest in buying Leopard's urban business if it came on the market.
There is no guarantee that any other parties would be prepared to purchase Leopard's business. Expressions of purchasing interest by third parties are inherently general and non-binding because they have no present means of knowing what returns are presently being made by Leopard Coachlines from the relevant bus routes. None of those purchasers have been provided with sufficient information that would give them any ability to make a reasoned response to the question as to whether they would purchase Leopard's operation. Without conducting a due diligence exercise, and without even knowing the price at which this transaction was to take place, in our view there can be little probative value in the statements allegedly made by those third parties.	The Commission acknowledges this point. The Commission acknowledges this point. The Commission is aware that there is no guarantee that those interested parties will buy Leopard's business. However, as Leopard claims to be profitable and other parties have shown interest in Leopard's business, it is more likely that Leopard will achieve a sale of its business. For these reasons, the Commission considers that the counterfactual should be the acquisition of Leopard by a third party.
If those persons have a vested interest in	[ ] did not make such comments.

driving down the price of a sale of Leopard's business, in the hope that they might purchase at a more favourable price, then their comments must be viewed with suspicion.	They only expressed some reservation with regards to price (if they were to buy it) and commented that Red Bus must have been offering a good price to prevent Leopard from looking for another prospective purchaser.
There is a considerable incentive on competitors in the market to attempt to frustrate the acquisition by Red Bus, by indicating some vague interest to the Commission in this way.	The Commission acknowledges that parties may supply misinformation. However, in this instance, the Commission received information by parties who said that they would potentially be interested in purchasing Leopard's urban business, subject to due diligence and sale price. The Commission considers this to be a reasonable response.
If consent to this transaction were declined, then the necessary effect will be to deprive (Leopard) of the ability to sell its business at a fair market price.	The issue for the Commission is not whether a business is sold at a fair market price but whether the proposed acquisition will substantially lessen competition. Furthermore, the Commission is concerned that possibly the reason why Red Bus would pay more for Leopard than other parties is because Red Bus would acquire greater market power as a result of the transaction.
Any third purchaser taking over Leopard's assets would not by virtue of the acquisition gain any significant competitive advantage- any more than would Red Bus itself gain from making the acquisition (beyond the unexceptional incumbent's advantages which would accrue to any party by reason of longstanding presence in, and familiarity with, the market).	The Commission does not agree with this view as [ ] said that they would gain some economies of scale if they acquired Leopard.
"In any event, there is absolutely no guarantee that any third party purchaser would provide a sustained presence in the Christchurch market." Any such acquisition, whether by Red Bus or any third party purchaser, is purely neutral in its competitive effect. Any purchaser (including Red Bus) would (in respect to the bus routes acquired from Leopard Coachlines) be vulnerable and subject to the	Whether the acquirer of Leopard's urban business will stay in the market or not when the runs are re-tendered will be determined through the competitive tendering processes managed by Environment Canterbury. The Commission's role is to ensure that the proposed acquisition does not substantially lessen competition in any market. The Commission is also concerned to

vagaries of the next forthcoming tender round in respect of those bus routes.	preserve the effectiveness of the tendering process. Furthermore, the Commission does not accept that "any such acquisition is purely neutral in its competitive effect". This is explained in the competition analysis below.
The purchase of Leopard's assets by an independent third party other than Red Bus would not in itself secure continued, active competition in the market. An independent third party purchaser would not, as a result of the purchase, be able to compete with Red Bus, because the purchaser and Red Bus would be operating different bus routes. Neither would retaining the ex-Leopard's bus routes in the hands of a party other than Red Bus have any wider effect of "keeping Red Bus honest" as may have been indicated to the Commission by a certain party.	The Commission agrees that there is very limited competition in the bus services market as a result of Environment Canterbury's policies not to allow registration of commercial services over subsidised services and to tender each route as a package of peak, off-peak, day, night and week-end runs. However, the Commission is also concerned with the impact of the acquisition on competition in the bus subsidies market. No such comments have been made to the Commission.
If Leopard were to cease to operate its urban bus business, Environment Canterbury would have to resubmit to tender Leopard's urban routes. Red Bus, together with any other party wishing to operate subsidised urban routes would have then the ability to tender for the ex-Leopard routes.	There is a substantial difference between Red Bus winning all of the ex-Leopard's routes through a competitive tendering process involving other bidders and Red Bus acquiring those same routes by a process whereby it bypasses the competitive tendering rounds.

Proposed counterfactual

135. The Commission has defined the counterfactual as Leopard selling its urban business to an independent third party for the following reasons:

(a) Leopard is committed to exiting the market;

(b) According to Leopard, the business is profitable;

(c) There are other potential purchasers of the business;

(d) Because the business is profitable, it is more likely that Leopard will achieve a sale of its business than close it down; and

(e) Because the business is profitable, it is likely that the purchaser will remain as vigorous a competitor as Leopard currently is.

136. The Commission acknowledges that the counterfactual is based on information provided by Leopard about its profitability and that it may have formed a different view if Leopard's urban routes were unprofitable.

Conclusion – Competition Analysis Principles

137. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be Red Bus does not acquire the urban business of Leopard and Leopard sells these routes to an independent third party. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

138. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints that might apply in the bus tendering market for subsidised services and the bus services market under the following headings:

- existing competition;
- potential competition from entry; and
- other competition factors.

ANALYSIS OF EXISTING COMPETITION

Introduction

139. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

140. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

Market shares

141. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure that yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors that lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[10]

142. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission's 'safe harbours', an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

Inter-firm Relationships

143. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.

144. Neither Red Bus nor any of its interconnected entities has a beneficial interest in, or is beneficially entitled to, any shares or other pecuniary interests in Leopard.

145. Neither Leopard nor any of its interconnected entities has a beneficial interest in, or is beneficially entitled to, any shares or other pecuniary interests in Red Bus.

Safe Harbours

146. Once the relevant markets have been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or

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[10] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

147. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

ANALYSIS OF EXISTING COMPETITION IN THE BUS SUBSIDIES MARKET

Existing Participants

148. Environment Canterbury has provided the Commission with a list of the operators that have bid since deregulation in 1991. Some of the bus operators, in addition to Red Bus and Leopard who have tendered for subsidised services since 2000 are described below. Other bidders between 1991 and 2000 have either stopped bidding or sold their urban business to another operator.

Ritchies

149. Ritchies operates urban buses in Auckland, Rotorua and Timaru. It also won the subsidised intercity service between Temuka and Timaru. It used to operate urban buses in Christchurch but stopped in 1997 after having reached an arrangement with Red Bus whereby it would lease its [ ] urban buses to Red Bus. The arrangement is coming to term and Ritchies has only [ ] buses still leased to Red Bus. [

]

150. Ritchies started bidding again [ ]. It won two contracts for operation of buses out of Christchurch: in Timaru and between Temuka and Timaru. [

]

IPT

151. IPT is a private company, which is well established in Invergargill and Dunedin where it has respectively nearly [ ] and [ ] of the runs. It is also involved in the tourism market, which represents about [ ] of its business.

152. IPT exited the Christchurch market in December 2000 when it sold its routes to Red Bus. [

]

[ ]

153. [
]

154. It said that [

]

[ ]

155. [

]

Geraldine Transport Service (“GTS”)

156. GTS is a small tour, charter and school buses operator of [ ] coaches. [ ] It operates the Twizel to Timaru subsidised service.

Market Shares

157. Market shares for subsidised services are listed in the Table 2.

Table 2: market shares for subsidised services

Operator	**Number of subsidised contracts operated**	**Market shares (% Number of subsidised contracts)**	**Market shares (% Revenue)**
Red Bus	[ ]	[ ]	[ ]
Leopard	[ ]	[ ]	[ ]
Ritchies	[ ]	[ ]	[ ]
Geraldine	[ ]	[ ]	[ ]

158. Leopard is currently running the “Christchurch award winning” Orbiter service, which carries [ ] passengers a year. The Orbiter is a loop service directly linking most major facilities in the suburbs of Christchurch. The first part of this service was introduced in 1999 and the second part in 2000. [

]

159. Should the acquisition of Leopard by Red Bus proceed, the merged entity would have [ ] of the subsidised contracts and [ ] of the revenues. These figures fall outside of the safe harbours.

Trend in the number of bidders since 1999

160. Table 3 shows the number of bidders for each contract tendered in 1999, 2000 and during the January 2001 to January 2002 period.

Table 3: number of bidders for each contract tendered since 1999

Number of bidders per contract tendered	Number of contracts tendered in 1999	Number of contracts tendered in 2000	Number of contracts tendered from January 2001 to January 2002	Adjusted number of contracts tendered from January 2001 to January 2002 if Red Bus and Leopard merged
2	1		5	[ ]
3		2	14	[ ]
4		5	4	[ ]
5	1	4		
6	3			
8	1			
Total	**6**	**11**	**23**	**23**

161. The operators that bid for the contracts tendered between January 2001 and January 2002 are the following:

- Red Bus tendered for [ ]
- Leopard tendered for [ ]
- [ ] tendered for [ ]
- [ ] tendered for [ ]
- [ ] tendered for [ ]
- [ ] tendered for [ ]
- [ ] tendered for [ ]

162. Table 3 shows that:

- There has been a decline in the number of bidders since 1999. In 1999, most of the contracts had five or more bidders whereas in 2001/2002 period most of the contracts had four or less bidders. This trend, which was confirmed by Environment Canterbury, is due to the fact that most of the small operators have either stopped bidding or sold their urban runs to Red Bus (such as Astro and IPT).

- In 2001/2002, [ ] contracts [ ] would have had only two bidders if Leopard and Red Bus were counted as one company.

163. In those [ ] cases, [ ] would have always been [ ] competitor[ ]. [ ] ability to compete against Red Bus in the future will therefore be crucial when assessing the countervailing power provided by existing competition.

164. As explained above, competition during the tendering process is twofold, as tenderers are evaluated on the quality of the services they propose (envelope A) and on the subsidy they submit (envelope B). These two dimensions of competition have therefore to be considered when assessing the impact of the proposed acquisition.

Competition for subsidies

165. In its application, Red Bus claimed that "the nature of the urban bus market dictates that prices cannot be raised or output or quality reduced without a significant impact on the operator concerned". "Regional Councils monitor prices and quality both through the tender conditions and on an ongoing basis during the life of bus routes contracts. Failure to meet the specified standards, including those set out in competitive pricing procedures can result in the contract being terminated by the regional authority, forfeiture of the performance bond or the imposition of fines. This means that there is no opportunity to unilaterally raise prices or reduce the level of service".

166. The Commission agrees that the operators are very limited in their ability to alter prices or services while they are working under a contract as Environment Canterbury fixes the fares and monitors quality. However, even though Environment Canterbury monitors subsidies during the tendering process, the subsidies themselves are determined by the tendering process; Environment Canterbury can only enter into negotiations about subsidies when there is a single tender. This will be discussed later in the section related to Environment Canterbury's countervailing power.

167. Red Bus claims in its application that it "potentially faces competition from Stagecoach, Ritchies and IPT". "They are all regular tenderers for urban routes throughout New Zealand and all of those companies have the financial resources and asset base which would enable them to operate at short notice from any substantial city in New Zealand".

168. The Commission has spoken to these companies and also smaller companies that have been bidding for urban bus routes the last two years. Their comments are detailed below.

Competition from existing operators

IPT

169. IPT had tendered in the past for those contracts that require up to [ ] vehicles. [ ]

- IPT said that it [

]

170. IPT said that [

]

171. However, it said that [

]

Ritchies

172. Ritchies said that that [

]

173. On the question whether it would bid at the same level as Leopard in the future if it acquired Leopard's routes, Ritchies answered that it depended on whether Leopard was currently profitable or not.

Stagecoach

174. Stagecoach [

]

[ ]

175. [ ]

176. [ ] it did not know whether it would carry on bidding as it cost a lot of money. [

]

177. [

]

[ ]

178. [ ] said it might tender again in the future depending on the opportunities, but it found it hard to meet the quality standards set by Canterbury Environment. Furthermore, it currently had sufficient work in the tour and charter market.

[ ]

179. [ ] said that it would not compete for Christchurch city urban runs, as it could not afford it.

[ ]

180. [ ] It said it could not compete against Red Bus and Leopard on subsidies, which had gone too far down. [ ]

181. Even though it is keeping an eye on the market, it does not consider it will enter the market again as the quality requirements set by Environment Canterbury require too much capital.

Conclusion on potential competition from existing operators

182. [ ] only operator[ ] committed to competing in the market at the moment. However, [ ] some concerns about the returns on investment [ ] if [ ] were to bid low enough to win contracts and some reservation on [ ] ability to compete actively in the future.

183. [ ] are keeping an eye on the market but are not active bidders. [ ] agree that subsidies are currently too low for them to compete in the market. However, Leopard, Red Bus and Environment Canterbury said that the returns were still reasonable. Red Bus and Leopard said they had returns on investment of about [ ].

Perspectives on competition and tendering process

184. Red Bus said that the threat of competition was enough to make sure that the process remained competitive. Furthermore, there was no opportunity to be complacent as anybody could enter; the market was tested by other competitors; and there might also be new entrants. Barriers to entry and likelihood of entry will be discussed below in the relevant sections.

185. [ ] said that the market was currently dominated by two large operators, Red Bus and Leopard, which had been competing aggressively. The current competitive situation might have therefore deterred some operators from competing.

186. It added that the acquisition would result in there being fewer bidders in the short term and therefore less competition. Red Bus might even be the only bidder during the next tendering rounds.

187. However, it believed that Leopard's exit would create market opportunities as, once those operators would have observed the "new" market without Leopard, they may start tendering and competing against Red Bus.

188. Furthermore, it did not think that subsidies would increase. If they did, other operators will certainly try to enter and compete, a fact that Red Bus would be aware of.

189. It added that Environment Canterbury had always encouraged competition and would do so in the future. The market was expanding and it was in its interest to find someone else to compete.

190. [ ] said that it was not opposed to the acquisition. Whether Leopard was in the market or not would not make any difference to it, as competition would still remain through the tendering process. The acquisition will encourage competition, as Leopard's exit will create a void that other operators will try to fill.

191. In terms of the outcome of the merger, [ ] said that subsidies might go up, as there would be a "monopolistic" situation with Red Bus having all the runs. But fares would not increase as they were fixed by Environment Canterbury. [ ] was actually hoping that subsidies would go up as it thought that they were currently "at a level where they should not be" (too low).

192. However, the acquisition would not have any impact on people's ability to tender. And the uncertainty as to who would bid would always be an element of the tendering process.

193. [ ] said that the competitive environment would change a little bit with the acquisition but that there would still be [ ] bidding and trying to get into the market, [ ]

194. Leopard said that the market was very competitive. The fact that nobody knew how many bidders there would be and the level of the bids made the process very competitive. Therefore there would still be competition in the market even though Leopard exited.

195. Environment Canterbury said competition had enhanced services and lowered subsidies.

- Subsidies per passenger and per resident are lower in Christchurch compared with the other centres.
- [ ]

196. It said it had worked hard to get competition and attract tenderers. [ ] It also used the Bus and Coach Association forum to keep in contact with operators.

197. It added that the environment was currently very competitive [ ]

- For large contracts, it has been relying on competition between [ ]
- For small contracts, there has been competition in that Environment Canterbury has offered smaller packages that small operators could tender for. [ ]

198. Environment Canterbury noted that there had been up to eight bidders for each contract two years ago. Over the past two years this had fallen to 2 - 4. [ ]

199. In a further submission, Red Bus said that: " the progressively smaller numbers of participants in the Christchurch market over the last few years is no accident. This gradual development is a direct outcome of the progressively lower economic returns, which have become available to operators. If there were higher returns available, obviously there would be more participants. This is simply a fact of economic life and is the result of Environment Canterbury's deliberate policy to keep subsidy levels low. As long as Environment Canterbury continues to keep subsidy levels low, there will tend to be fewer entrants into the market. In order to achieve its goal of keeping subsidies low, Environment Canterbury is not reliant upon a relatively higher number of tenderers. This is because Environment Canterbury itself sets the pricing parameters which it wishes to achieve and would negotiate to achieve those parameters, even if there were only a single tenderer for any bus route."

200. The Commission notes that it disagrees with Red Bus' assertion that Environment Canterbury has a deliberate policy and the ability to keep subsidies levels low. Policy 3.3 of the Regional Passenger Transport Plan 2001 states:

"Subject to maintaining satisfactory user and community contributions through fares and rates, Environment Canterbury shall seek to maximise the use of central government grants through Transfund New Zealand in the funding of public passenger transport services in Canterbury".

The mere fact that Environment Canterbury seeks to minimise the subsidies granted (or maximise the use of public funding) does not mean that it can directly control the level of subsidies. This is determined by the bidding process, not dictated by Environment Canterbury.

Conclusion on perspective on competition and tendering process

201. The historical trend is for there to be a declining number of bidders. [

]

202. The operators seem to agree that the uncertainty around the tendering process as to how many operators will bid and at which level puts pressure on the bidders to lower their bids and that this uncertainty and their ability to bid would not be changed by the proposed acquisition. However, the Commission notes that this is somewhat at variance with the operators' behaviour as there has been a decline in the number of bidders in recent years.

203. Some operators and [ ] also believe that Leopard's departure would create some market opportunities and that operators who had not been able or had not wanted to compete against the two current dominant players could enter in the short term, once they have observed the market without Leopard. The [ ] also claimed that subsidies would not increase as Red Bus would be aware that an increase would trigger entry.

204. However, the Commission notes that these operators said that they would not enter at the current level of subsidies, as it was too low. As explained below, the Commission considers that entry is most likely at Environment Canterbury's budget level and consequently is likely to occur only when contracts are awarded around this level. The

Commission notes that the budget level is more than [ ] greater than the current level of subsidies.

Comparison of the bids submitted since 2001.

205. Tables 4, 5 and 6 below show the bids the operators have submitted for each contract tendered by Environment Canterbury since January 2001. Contracts 196 to 205 inclusive were tendered in January 2001, contracts 206 to 215 were tendered in April 2001 and contracts 216 and 217 were tendered in January 2002. The latter were for bus services in Timaru and between Timaru, Temuka and Twizel.

- Tables 4, 5 and 6 provide a comparison of the bids between [ ] for each contract. For example, for contract number 201: [ ]

206. Every year, Environment Canterbury (together with an independent estimator) estimates the subsidies operators will require to run the services it will tender the following year and budgets for them accordingly. The tables also provide a comparison of the bids to Environment Canterbury's budgeted subsidy for each contract. For example, for contract number 196, [ ]

Table 4: Comparison of the bids submitted for contracts 196 to 205 (January 2001)

[ ]

Table 5: Comparison of the bids submitted for contracts 206 to 215 (April 2001)*

[ ]

Table 6: Comparison of the bids submitted for contracts 216 and 217 (January 2002)
[ ]

Chart 1: comparison of bids to Environment Canterbury's budgeted price for 2001/2002

[ ]

207. With regard to the comparison of bids between the tenderers, Tables 4, 5 and 6 show that:

- [ ]

208. With regard to the comparison of bids with Environment Canterbury's budgeted subsidy:

- [ ]

209. Furthermore, Environment Canterbury publishes the number of bidders and the winning, lowest and highest bids. Therefore Red Bus knew that there was always a bidder between itself and the most expensive one, but could not know how close to its own bid the middle one was. This would have put some pressure on it to maintain low bids.

Conclusion on the comparison of the bids submitted since 2001

210. The acquisition removes Red Bus' most effective competitor (Leopard) from the market. Without Leopard, [ ]

211. Under the counterfactual, the Commission has assumed that the party that purchased Leopard would continue to bid at Leopard's prices. This is based on Leopard's claims that it is earning a satisfactory return from its urban bus operations and is not selling this part of its business for financial reasons.

212. The tables also show that even under the counterfactual (as represented by the status quo) [ ] and so this element of price competition would be potentially lost by Leopard not bidding.

213. Leopard's exit from the market would have a further negative impact on the competitiveness of the market. Currently, with a three-bidder situation, Red Bus is unaware of the margins between it and the next bidder. However, with a two-bidder situation, given Environment Canterbury's policy of publishing the lowest and highest bid, Red Bus would immediately observe the margin between it and its rival giving it the potential to substantially increase its prices [
]

214. In further submissions to the Commission, Red Bus and Leopard said that they disagreed with the Commission's conclusions on competition. Red Bus and Leopard's arguments against the Commission's conclusions and the Commission's responses are listed in Table 7.

Table 7: Red Bus and Leopard submissions against the Commission's conclusions on competition and the Commission's responses

Red Bus and Leopard arguments against the Commission's conclusions on competition	**The Commission's responses**
The Commission suggests that the acquisition would eliminate Red Bus' strongest competitor, and the only competitor that appears to be providing a meaningful constraint on Red Bus. However, the data provided as to the number of tenders in recent tender rounds does not support this view. There is clear empirical evidence that there have been a number of active potential participants through the lodging of tenders in the market and that accordingly there is vigorous, actual competition in the market	The data provided by Red Bus were for the 1999 and 2000 tender rounds. Since then, there has been a decline in the number of bidders as shown in Table 3. The only active competitors in the market are currently Red Bus; Leopard; [ ]. All the other ones have either stopped bidding or sold their runs to another operator. As explained above, [ ] of the contracts let in 2001 would have had 2 bidders if Leopard and Red Bus were counted as one company.
Red Bus views Ritchies (and not Leopard) as its strongest competitor. Ritchies is a far greater company in terms of size, capital, buses, staff, history and national presence. Ritchies operate main	The Commission recognises that Ritchies is a very active bidder and that it is a large company with enough resources to be able to compete. However, the Commission has found that: ➢ Leopard [

contracts in a number of locations. It does actively participate in the Christchurch tender process and is an operator in Timaru as overseen by Environment Canterbury. Furthermore, Ritchies already has a large operation including depot and staff in Christchurch.	] ➢ Leopard had won some routes in Christchurch in 2001 whereas Ritchies had not won any routes for several years (apart from inter-city routes); ➢ Leopard was an established operator in the bus subsidies market and as such benefited from economies of scale and scope and market knowledge, which allowed it to bid at a lesser price. ➢ Even though Ritchies was already established in Christchurch it did not have any urban buses. [ ] ➢ As shown in Tables 4 and 5, Ritchies was on average [ ] and [ ] more expensive than Red Bus for the January 2001 and April 2001 tendering rounds compared to [ ] and [ ] for Leopard.

Conclusion on competition for subsidies

215. There have been a declining number of bidders since 1999. [ ] of the tenders let from January 2001 to January 2002 would have had only 2 tenderers if Red Bus and Leopard had been one company.

216. Amongst the current competitors, [ ] seem to be the most committed. [ ] are keeping an eye on the market but would only be prepared to bid if the subsidies increased.

217. The uncertainty around the tendering process as to how many operators will bid and at which level seems to put pressure onto the bidders and lowers the bids. [ ]

218. However, the acquisition removes Red Bus' most effective competitor (Leopard) from the market.

219. Currently, with a three-bidder situation, Red Bus is unaware of the margins between it and the next bidder. However, with a two-bidder situation, given Environment Canterbury's policy of publishing the lowest and highest bid, Red Bus would immediately observe the margin between it and its rival, giving it the opportunity to increase its subsidies.

220. As [ ] Red Bus would therefore have the ability to substantially increase its prices.

221. Therefore, the Commission considers that the acquisition removes the strongest and most effective competitor from the subsidies market and that the current competitors would exert very little market constraint on the merged entity.

Implication of quality standards

222. Environment Canterbury said that competition had helped to improve the quality of the services provided in Christchurch. It has always been motivated to improve quality and introduce new services and even more so now with patronage funding. Furthermore, improving public transport is a way for it to decrease pollution and meet its target in terms of decreasing CO2 emissions.

223. The quality of the services provided has improved through:

- Investments in new vehicles, ticketing machines, uniforms etc;
- Increased frequency of buses, which for some routes run every 15 minutes (as opposed to 30 minutes before);
- Development by Environment Canterbury of an umbrella brand “Metro” for all the components of the services it provides (bus stops, time tables, telephone numbers etc);
- Investments made by operators to improve their image: presentation and friendliness of drivers and cleanliness of vehicles; and
- Investment in infrastructure: bus shelters, Real Time Information, Bus Exchange (opened 6 months ago by the Christchurch City Council).

224. Environment Canterbury has turned down the cheapest operator twice [ ] on quality grounds, making it clear that it wanted to have quality as well as low prices.

225. Environment Canterbury commented that [

]

226. Some small operators commented on the high quality standards set by Environment Canterbury in the tender documents as they thought that it would be a barrier for them to enter or re-enter the market. This will be discussed below in the relevant section.

Conclusion on competition in the bus subsidies market

227. The uncertainty around the tendering process as to how many operators will bid and at what level helps to create a competitive environment and reduce subsidies.

228. However, the acquisition removes Red Bus’ most effective competitor in terms of both quality and prices (subsidies). [

]

229. The information disclosure associated with the tendering process, whereby the highest and lowest bids are published, will exacerbate this. This means the price (subsidy) increases could be much greater.

230. Therefore, the Commission is not satisfied that the acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in the bus subsidies market.

ANALYSIS OF EXISTING COMPETITION IN THE BUS SERVICES MARKET

231. There are four providers of bus services in Christchurch: Red Bus, Leopard, Ritchies and Geraldine Transport Services.

232. Both commercial and subsidised routes are independent and most often do not compete against one another. Once a contract has been awarded, there is effectively no competition amongst the operators. Competition only occurs on the main trunks of the city centre where all the routes converge.

233. Competition could potentially occur from the provision of a commercial service in opposition to a subsidised service. However, the impact of Environment Canterbury's policy of tendering each route as a package of peak, off-peak, night, day and week-end runs deters competition from commercial services from occurring on subsidised routes.

234. Also, the economics of public transport provision makes it unlikely that commercial services will be developed and provided in opposition to, or instead of, subsidised services. For these reasons, the Commission considers that the acquisition will not have the effect of substantially lessening competition in the bus services market.

SCOPE FOR THE EXERCISE OF COORDINATED MARKET POWER IN THE BUS SUBSIDIES AND BUS SERVICES MARKET

Introduction

235. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

236. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination; 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

237. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the

potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

238. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

Bus subsidies market

239. Within the subsidies market a collusive arrangement, if it were to happen, is likely to involve some form of sharing of contracts. Because of the winner-takes-all nature of the tender for each contract, it would not make any sense for any co-ordination to focus on raising the price (subsidy) without providing some form of reward in terms of being awarded contracts.

240. One way this could occur would be for parties to agree implicitly or explicitly to "stick to their routes".

241. In Auckland for instance, [ ] the Auckland Regional Council noted that [ ]

242. Recently there does not appear to be this type of behaviour in Christchurch, notwithstanding that in 1998 Red Bus, then Christchurch Transport Limited, was fined $400,000 for attempting to fix the prices (level of the bids and winner) of the route contracts tendered by Environment Canterbury. During 2001, both Red Bus and Leopard bid for, and won, routes for which the other was the incumbent. Furthermore, there is no evidence of any current collusion between operators in the bus subsidies market.

243. If the Red Bus/Leopard merger were to proceed, Red Bus would have all the routes in urban Christchurch, while other operators, Ritchies and GTS, would share the non-Christchurch routes. These non-urban routes are relatively small so, though they may be a useful complement to other transport operations, it is unlikely that the risk of losing them would deter these companies from competing with Red Bus if they wanted to enter the Christchurch urban market segment. Furthermore, Leopard currently does not operate, or compete, in the non-Christchurch segment, so its absence would not necessarily impact on any dynamic amongst Red Bus and the other operators.

Bus services market

244. The bus services market has little scope for collusion, since each route is, over the length of the operators' contract, virtually a monopoly.

Conclusions – Co-ordinated Market Power

245. For these reasons, the Commission does not consider that there will be a substantial lessening of competition as a result of co-ordinated market power in the bus subsidies and bus services markets.

CONSTRAINTS FROM MARKET ENTRY

Introduction

246. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

247. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

248. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

249. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

250. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

251. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

252. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

Barriers to entry

253. The applicant contends that the barriers to entry into the market are not significant.

254. In Decisions 318, 326 and 460, the Commission was sceptical as to the prospect of new entry in the bus services market and listed a number of barriers or conditions to entry:

- regulatory requirements (passenger service licence, registration for commercial services, compliance with more stringent Vehicle Quality Standards, performance bond to be lodged when bidding for a subsidised service);
- capital costs of entry (good quality buses, infrastructure, staff, etc.);
- sunk costs;

- passenger information access costs when bidding for contract services;
- economies of scale (for the infrastructure) and scope (linking routes);
- access to routes (size of contracts limited to 10-12 buses);
- availability of staff and vehicles;
- customers' requirements (quality of buses, certainty, one network and one fare system);
- access to bus stops; and
- response of the incumbent.

255. The above conditions/barriers to entry would also appear to apply to the Christchurch bus subsidies market. Interviews with potential entrants have suggested that the main barriers are likely to be the quality requirements set by Environment Canterbury, the economies of scale and scope and the incumbent's market knowledge.

256. Red Bus is likely to enjoy significant economies associated with its networks, unobtainable by small-scale entrants or tour operators. The economies emerge from operating many complementary bus routes throughout the region, and being better able to organise its fleet to minimise downtime. There are also likely to be significant economies derived from the scale of its operation – costs such as management, administration, and depot facilities generally increase less than proportionally with output. This would allow it to bid at a lower level than existing small competitors and new entrants.

257. A fledgling entrant, operating on a limited number of routes, might also be deterred by the financial strength of a competitor such as Red Bus, which could potentially cross-subsidise by using profits earned on performing routes.

258. A number of small operators have commented on the quality requirements set by Environment Canterbury in each tender document. Most of the contracts that come out for tender require new super low floor buses, which cost each $250,000 plus $10,000 for a new ticketing machine. This requires a substantial investment that not all of the small operators would be ready to make and could afford.

259. [ ] said that the Red Bus' market knowledge with regards to patronage and fare revenue was the main reason why [ ] could not win any contracts in Christchurch. Given that Environment Canterbury does not share its market knowledge with all potential bidders, incumbents clearly do have an advantage. Even if not the incumbent of a particular run, participation in other routes would assist. However, Tables 4, 5 and 6 show that the incumbent does not always win when routes are re-tendered (contracts 201, 207 and 208).

260. Past history shows that entry into the bus subsidies market has been possible. Astro, Ritchies, IPT, Leopard and other small companies entered the market after deregulation in 1991. However, all these companies were already in the local transport market as tour, coach or school buses operators. There has not been any de novo entry. It is also significant that, apart from Leopard, these companies have not been particularly successful. Entry has not been sustained.

261. Consequently, the Commission considers that while each of the entry conditions outlined above do not necessarily individually represent a large barrier to entry, their cumulative effect aggregates into a substantial barrier to entry.

The "LET" Test

262. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition, which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

263. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

264. The Commission considers that entry can be assessed from two perspectives. First, whether there is likely to be entry by a large, established bus company.

265. Red Bus claims that it could potentially face competition from Stagecoach and that three overseas transport operators (Transdev, First Bus and Connex) could easily enter the New Zealand market.

266. [ ] said that it was not interested in entering the bus subsidies and services market in Canterbury, as subsidies and fares were currently too low. [ ]

267. [ ] said that it would not be interested in entering [ ] and competing against Red Bus. [ ]

268. Commission staff also spoke to [ ], which said that it was not interested in the New Zealand market for the time being as [ ]

269. The Commission tried twice to contact Connex. However, no one from Connex replied to the Commission's inquiries.

270. First Bus tried to enter the Auckland bus market by bidding for a series of routes on the North Shore. It won some tenders but New Zealand Bus Limited registered commercial routes across some of these contracted routes. This reduced the volume of business that First Bus effectively won and it exited the Auckland market. The Commission did not contact First Bus.

271. Based on these responses, the Commission concludes that entry by a large established bus company is unlikely in the future.

272. The second perspective is whether entry is likely from one or more of the smaller operators.

273. Indications from some of these, in particular [ ], are that entry is possible. But an important caveat is that entry is unlikely at current subsidies levels. [ ] said that they had stopped bidding or exited the market because the subsidies were too low and they could not compete at that level. Some of them said that they would consider bidding again if subsidies increased.

274. The Commission notes that [ ], an operator with some complementary local bus business [ ] generally bids around the budget level. It therefore considers that the subsidy levels would need to be around this level for entry by these smaller operators to be likely.

275. As shown in Table 4, 5, and 6, if entry were to happen at budget level, it would happen at a price often more than [ ] higher than the current price.

276. In contrast, when asked how they would bid if they were owners of Leopard, [ ] indicated they would be able to attain some economies as a result of already having an established operation, and therefore be more likely to bid at the lower level that Leopard currently does.

277. The Commission therefore concludes that entry by a small operator is unlikely in the future at current subsidy levels.

Conclusion on the likelihood of entry

278. The Commission considers that entry in the bus subsidies market is unlikely from both small and large operators.

279. Furthermore, the likelihood of entry into the bus services market separate from entry into the bus subsidies market is very low because of the economics of public transport provision.

Extent of Entry

280. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

281. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that “toe-hold” position may be difficult because of the presence of mobility barriers, which may hinder firm’s efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the ‘extent’ of entry.

282. If entry into the bus subsidies market were to occur, it would necessarily be on a small scale as subsidised contracts are let on a staggered basis once or twice a year. The marginal cost of bidding for additional routes would not be that high.

283. However, bidding on a large scale may not translate into success on an equal scale. In the past, in both Christchurch and Auckland, new entrant operators have suffered from not winning sufficient contracts to maintain a viable business and have subsequently left the market. The Commission notes, however, that this has not been a universal experience as Leopard, an established tour, charter and school buses operator, initially won one route and has built its market share from this low level.

Timeliness of Entry

284. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are affected detrimentally to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

285. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

286. Though each bus contract is for several years, the schedule for tenders means that there is a steady flow of bidding opportunities. Timeliness of entry would not be a problem.

Further submissions from Red Bus and Leopard

287. In further submissions to the Commission, Red Bus and Leopard said that they disagreed with the Commission's conclusions on entry. Red Bus and Leopards arguments against the Commission's conclusions and the Commission's responses are listed in Table 9.

Table 9: Red Bus and Leopard submissions against the Commission's conclusions on entry and the Commission's responses

Red Bus and Leopard arguments against the Commission's conclusions on entry	**The Commission's responses**
There is no reason why Leopard's growth cannot be replicated by any other market participant.	The operators interviewed by Commission's staff and who would potentially be able to replicate Leopard's growth in the market said that they would not enter the market because subsidies were currently too low and because of incumbency advantages and economies of scale, which prevented them from matching Red Bus' bids.
Environment Canterbury and Transfund actively encourage the entry into the market of smaller operators, by ensuring that a number of small tenders are let in any tender round.	The financial implication of Environment Canterbury's stringent quality requirements discourages some small operators from entering the market. Environment Canterbury's policies of tendering each route as a package of peak, off-peak, night, day and week-end runs tends to deter small scale entry on a commercial basis. Small operators said they could not compete on price against Red Bus. While Environment Canterbury may wish to encourage entry from small operators, the latter told the Commission that the current level of subsidies was too low to allow them to compete against Red Bus.
The evidence clearly shows that there are no "first mover" advantages from incumbency, which can accrue for the benefit of Red Bus, to the detriment of any potential new entrant into the market. This is because: ➢ The cost of mounting a tender are the same for both the incumbents and new entrants; ➢ Buses (both new and second hand) can readily be purchased or leased and are often acquired by an incoming tender winner from the	The Commission considers that the incumbent benefits from advantages that new entrants would not have. The Commission is of the view that: ➢ The incumbent's cost of mounting a tender is less than the cost incurred by the other bidders as it benefits from the market knowledge gained while operating the relevant bus services such as fare revenue and patronage. These figures have to be established by the other bidders by employing people to count passengers and establish the fare revenue.

outgoing operator; ➢ Employees become available in the same way ➢ There are ready sources of finance available to winning tenderers ➢ The same infrastructural costs arise to both incumbents and new entrants. ➢ Much of the infrastructure is supplied by Environment Canterbury. The incumbents will continue to face the same ongoing costs as would new entrants, because of the need to comply with Environment Canterbury's quality and service standards, pursuant to the terms of the relevant bus route contracts	➢ The incumbent already possesses the fleet and staff required to operate the routes, unless Environment Canterbury changes its requirements. ➢ Furthermore, the Commission understands that there is a shortage of conventional second hand buses and the existing super low floor buses are all dedicated to runs so that there is a limited or no second hand market for these buses. Although there is enough capacity available to build new super low floor buses and the timeframe set by Environment Canterbury allows for buses to be built before the contracts start, the Commission considers that the capital expenditure required to operate those contracts acts as a deterrent for small operators. ➢ Red Bus said that it had never sold buses after having lost a contract as buses could be put on other runs or replace buses reaching the age limit. ➢ The Commission agrees that sources of finance are available. However, some of the small operators interviewed said they would not be able to afford a new fleet if they won a contract.

Conclusion on Entry

288. The main barriers to entry appear to be:

- The benefits of the network effects that Red Bus gains as the principal incumbent. This allows it to price more cheaply than other operators;
- The incumbency advantages such as market knowledge; and
- The quality standards set by Environment Canterbury in its tendering documents, as they require investments that some small operators cannot afford.

289. Furthermore, small and large operators are not prepared to enter the market at the current level of subsidies. The Commission considers that for operators without any contracts, entry would only be likely once subsidies have reached Environment Canterbury's budget level. This would be at a level [ ] greater than the current level.

290. Finally, because of the nature of the market, entry would have to be first on a small scale. Leopard is the only entrant that has successfully grown its market shares since 1991. All the other operators have exited the market or are operating on a very small scale.

291. The Commission concludes that cumulatively the barriers to entry are sufficiently high and that entry on a scale significant enough to constrain the merged entity is unlikely at current level of subsidies.

OTHER COMPETITION FACTORS

Constraint from Buyers or Suppliers

292. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

293. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

Countervailing power exerted by Environment Canterbury

Fares

294. Fares charged by the operators of subsidised services for bus trips are fixed by Environment Canterbury and cannot be raised unilaterally by the operators, as this would be a contractual breach. Operators are allowed to decrease the fares below the maximum fare set by Environment Canterbury and have done so in the past.

295. The maximum fares have only been increased once since deregulation in 1991. This increase was initiated by Environment Canterbury to improve bus-loading time and was done in consultation with the operators. The fares increased from $1.80 up to $2 (the "gold coin" fare).

296. Red Bus said that it [ ]

297. The Commission concludes that with respect to fares, Environment Canterbury exercises substantial countervailing power.

Subsidies

298. Every year, Environment Canterbury budgets the subsidies it will need for the next year's tendering rounds as shown in Tables 4, 5 and 6. However, the actual amount it will have to pay to the operators will be determined by the tendering process. The extent and nature of competition is therefore crucial in determining the level of subsidies paid.

299. As a recipient of Government funding, Environment Canterbury is obliged to comply with the system outlined from paragraph 32 to 55. This system allows Environment Canterbury some discretion, for instance in terms of specifying the routes that form the

contracts. The applicant has claimed that Environment Canterbury uses this discretion to package the contracts in a way that will encourage competition.

300. However, it is also the case that Environment Canterbury's discretion is limited by the regulations applying to the CPPs it must follow in awarding contracts. For instance, there are limits on the size of the contracts that can be awarded.

301. As set out in the CPPs by Transfund, Environment Canterbury has to choose the lowest quality-adjusted price amongst the ones submitted and can only negotiate the price when there is one tenderer. If current competition were maintained after the acquisition there would generally be at least two bidders. Therefore Environment Canterbury would not be able to negotiate over the level of subsidies.

302. In a further submission, Red Bus said that "even if Red Bus were the only tenderer in respect of any contract, if Environment Canterbury took the view that Red Bus' pricing or proposed service level were unacceptable in any respect, Environment Canterbury retains the discretion not to award a tender and is not obliged to accept any tender. In this way, Environment Canterbury retains and will continue to exercise a strong supervisory function, in order to protect the public interest."

303. Environment Canterbury has negotiated price twice since deregulation:

- In April 1994: [ ]
- In December 1996: [ ]

304. This indicates that Environment Canterbury has had some countervailing power within the price negotiations when there was one bidder. [ ]

305. In addition, the Commission notes that price negotiation occurred in 1994 because [ ]. If Red Bus were the only bidder on a contract in the future and increased its prices by on average [ ], its bids would still be "acceptable" as within Environment Canterbury's budget but Environment Canterbury would have limited grounds for negotiating a price decrease [ ]

306. Furthermore, if current competition were maintained after the acquisition, there would generally be at least two bidders [ ] and Environment Canterbury would have to choose amongst the prices submitted. If Red Bus increased its prices by more than [ ] while being still cheaper and therefore still within the "acceptable range", Environment Canterbury would not be able to negotiate the price because there were two bidders (as set in the CPPs by Transfund).

307. The Commission concludes that while Environment Canterbury has a degree of countervailing power whenever it receives just one tender, its position is much weaker when there are two or more tenderers.

308. The Commission considers that Environment Canterbury has insufficient countervailing power in the bus subsidies market to prevent a substantial lessening of competition.

COMPARISON WITH DECISION 326

309. In Decision 326, the Commission authorised the acquisition of Transportation Auckland Corporation Limited by New Zealand Bus Limited because of the countervailing power exercised by the Auckland Regional Council.

310. In Decision 326, the Commission stated "it believes that without ARC regulation the merged company would be dominant in the market. However (….) the regulatory power of regional councils is intended to counter the market power of major incumbents. Hence the Commission has concluded, on balance, that the merged entity would fall short of dominance."

311. Significantly however, the Commission is now considering the matter under the substantial lessening of competition threshold rather than the dominance threshold that applied in Decision 326.

312. In submissions to the Commission, the applicant has argued that this decision provides a precedent for this investigation: "Whilst it is accepted that the Commission's Decision No 326 was decided under the Commerce Act 1986 prior to the enactment of the Commerce Act Amendment Act 2001, we submit that the decision is still directly relevant to the present application. This is primarily because, just as was the case in respect of the Commission's Decision No 326, the overriding control exercised by Environment Canterbury in the exercise of its statutory functions has the effect that there will not, and is not likely to, be a substantial lessening of competition in the relevant market as a result of the acquisition by Red Bus".

313. Furthermore it has claimed that the greater incidence of commercial services in Auckland than in Christchurch was not material to the present application.

314. However, the Commission considers that the greater incidence of commercial services in Auckland, where more than 40% of the bus services are commercial, led the Commission to assess Auckland's Regional Council's countervailing power against attempts by operators to increase fares but not subsidies.

315. As stated in Decision 326: "It has also been pointed out that in the Greater Wellington market, in which NZ Bus holds a very large market share, and where it faces limited actual and potential competition, there have been no fare increases since 1992, and that while subsidies have increased this has been accompanied by an increase in the volume and quality of services. However, without conducting a detailed analysis it is difficult for the Commission to ascertain whether NZ Bus might be exercising market power in that market."

316. With regards to the proposed acquisition, the Commission has found that Environment Canterbury undoubtedly wielded direct countervailing power with respect to fares.

317. However, it has found that Environment Canterbury would have limited countervailing power to stop subsidies from increasing if the proposed acquisition were to proceed.

OVERALL CONCLUSION

318. The Commission has considered the probable nature and extent of competition that would exist in the bus subsidies market and bus services market. The Commission considers that the appropriate benchmark for comparison is for Leopard to be sold to a third party.

319. The Commission has considered the nature and extent of the contemplated lessening of competition. The proposed acquisition would result in the merged entity obtaining market shares that fall outside the Commission's safe harbour guidelines.

320. The Commission has also considered the nature and extent of the contemplated lessening of competition, in terms of the competitive constraints that would exist following the merger from:

- existing competition;
- potential competition from entry; and
- other competition factors.

321. However, the Commission is not satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the bus subsidies market.

322. New entry will not provide an efficient constraint, as it is only likely to occur at the budgeted subsidy, which is [ ]

323. Environment Canterbury is able to exercise some countervailing power with respect to fares. However, it is reliant on the nature and extent of competition to ensure that subsidies will not increase and the Commission concludes that it would not be able to exercise sufficient countervailing power in the bus subsidies market to prevent a substantial lessening of competition.

324. The Commission is satisfied that the propose acquisition would not have nor would be likely to have, the effect of substantially lessening competition in the bus services market.

325. The Commission acknowledges that Red Bus' present market share and the current low level of subsidies are likely to be attributable to its efficiencies and superior performance. However, it also considers that Leopard's competitive presence constrains the exercise by Red Bus of market power and contributes to the maintenance of efficiencies and low subsidies in the market. The removal of the most effective competitor from the market would also remove this effective constraint.

326. Based on the assumptions made in the counterfactual (which would effectively see a third party step into Leopard's shoes), the Commission is not satisfied that the

acquisition would not substantially lessen competition in the market for the rights to operate scheduled, subsidised bus passenger services in Christchurch and Timaru (the bus subsidies market).

DETERMINATION ON NOTICE OF CLEARANCE

327. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to decline clearance for the proposed acquisition.

Dated this 30 July 2002

John Belgrave

Chair