COMMERCE ACT 1986: BUSINESS ACQUISITION

SECTION 66: NOTICE SEEKING CLEARANCE

December 2005

The Registrar
Business Acquisitions & Authorisations
Commerce Commission
P O Box 2351
WELLINGTON

NEW ZEALAND BUS LIMITED/MANA COACH SERVICES LIMITED

Pursuant to s.66(1) of the Commerce Act 1986, notice is hereby given seeking **clearance** of a proposed business acquisition. <u>This notice should be read with the accompanying introduction and the supporting papers</u>.

PART I : TRANSACTION DETAILS

PART I: TO BE COMPLETED BY ALL APPLICANTS

1 <u>The business acquisition for which clearance is sought</u>:

*1.1 Identify **what** is to be acquired and **who** is to acquire this.*

1.2 Attach a copy of any contract or agreement relating to the proposed acquisition.

1.3 Any notice of clearance will be given only in terms of the above description and, accordingly will cover only:

- *the acquisition of the shares/assets specified under this paragraph of your notice, and*
- *the acquisition of those shares/assets by the person identified in this paragraph as the person who proposes to make the acquisition.*

The acquisition for which **clearance** is sought is the purchase by **NEW ZEALAND BUS LIMITED** or interconnected body corporate (**NZBL**) of the balance of 74% shares in:

- **MANA COACH SERVICES LIMITED** ("**MANA**")

THE PERSON GIVING NOTICE

2 Who is the person giving notice?

2.1 State the name (including both the name of the company and the name/position of the individual responsible for the notice), postal address, telephone and facsimile numbers.

Mr Ross Thomas Martin
Executive Chairman
New Zealand Bus Limited
P O Box 14070
Wellington

Telephone: (04) 802 4100
Facsimile: (04) 802 4259

2.2 Section 66(1) provides that "A person who proposes to acquire assets of a business or shares may give … notice …" If a notice is given by an agent (eg. a solicitor) on behalf of the acquirer then you must also give contact details of the acquirer.

CONFIDENTIALITY

3 Do you wish to request a confidentiality order for:

3.1 The fact of the proposed acquisition?

3.1.1 If so, for how long?
3.2.2 Why?

Yes until the final contract with Mana is signed. It is hoped that this will be in the next short while.

3.2 Specific information contained in or attached to the notice?

3.2.1 If so, for how long?
3.2.2 Why?

Confidentiality is sought for the information at paragraphs 10, 21(a), A8 and A9 relating to the purchase price of the shares in Mana, total fare income, the total subsidies received under the contract services and the subsidy levels in respect of the trolley buses. Confidentiality is also sought for the contract itself.

Indefinite confidentiality is sought.

The grounds are that this information is commercially sensitive.

DETAILS OF THE PARTICIPANTS

4 Who are the participants (ie. the parties involved)?

(a) Acquirer

New Zealand Bus Limited
or interconnected body corporate
P O Box 14070
Wellington

Telephone: (04) 802 4100
Facsimile: (04) 802 4259

(b) Target

Mana Coach Services Limited incorporating:

Newlands Coach Services
Mana Coach Services
7-9 Commerce Crescent
PORIRUA

Telephone: (04) 235 8819
Facsimile: (04) 235 7037

Attention: Kerry Waddell, Managing Director

5 Who is interconnected to or associated with each participant?

5.1 Acquirer group/associates:

5.1.1 If the acquirer is a member of a group of interconnected bodies corporate identify all members of the group.

5.1.2 Identify all companies in which the acquirer or its interconnected bodies corporate own 10% or more or the shares.

5.1.3 Identify any company which owns over 10% of the shares in the acquirer or any company of which the acquirer is a subsidiary.

5.1.4 Identify all interconnected bodies corporate of any company identified under 5.1.3 and all companies of which it, or its interconnected bodies corporate, own over 10% of the shares.

NZBL is the 100% holding company for Wellington City Transport Limited, Cityline (NZ) Limited and Transportation Auckland Corporation Limited, which companies operate the New Zealand bus businesses known as Stagecoach Wellington, Cityline Hutt Valley and Stagecoach Auckland.

NZBL is also the 100% holding company for:

- Harbour City Cable Car Limited – a shelf company;
- North City Bus Limited – (trading as Runciman Motors).

NZBL also owns:

- 96% of Fullers Group Limited;
- 26% of Mana;
- 50% of Wellington Integrated Ticketing Limited.

NZBL is, in turn, a wholly owned subsidiary of Infratil Limited. That company holds a wide range of infrastructure assets, particularly airports, but none of these are related to the markets in question. The only shareholder in Infratil within excess of a 10% holding is Utilico Investment Trust plc (with approximately 19% of the shares), a United Kingdom based infrastructure focussed investment trust

5.2 Target company group/associates:

5.2.1 Identify all subsidiaries of the target company and all companies in which the target company or any subsidiary owns 10% or more of the shares.

5.2.2 If any company owns over 10% of the shares in the "target company", and will continue to do so ***after*** *the proposed acquisition:*
Identify all interconnected bodies corporate of the company and all companies in which it or its interconnected bodies corporate own over 10% of the shares.

Mana is owned by:

Blairgowrie Investments Limited	60.65%
K Waddell and R Treadwell	3.00%
I Waddell and K Cosgrove	2.85%
Copland Neyland Assocs. Limited	7.50%
NZBL (through Wellington City Transport Limited)	26.00%

The first 4 shareholding groups are the vendors.

Mana owns:

Newlands Coach Service (1998) Limited (shelf company for name protection purposes) and 50% of Wellington Integrated Ticketing Services Ltd

5.3 *For the purposes of questions 5.1.1 - 5.1.4 and 5.2.2, any entity other than a company should be regarded as if it were a company – with the appropriate modifications. For example, an unincorporated joint venture which is owned 50/50 by two persons is regarded as a company with each person holding 50% of the shares.*

Not relevant.

6 <u>Does any participant, or any interconnected body corporate thereof, already have a beneficial interest in, or is it beneficially entitled to, any shares or other pecuniary interest in another participant</u>?

6.1 If yes, identify the number, description and amount.

Yes, NZBL (through Wellington City Transport Ltd) holds 26% of the shares in Mana (ie. 6,500 shares). It is not, however, represented on the Board and plays no part in the management of Mana. This holding was acquired in 2000.

7 <u>Identify any links, formal or informal, between any participant/s including interconnected bodies corporate and other persons identified at paragraph 5 and its/their existing competitors in each market</u>.

NZBL and Mana together own Wellington Integrated Ticketing Limited. The shareholding is as follows:

Wellington City Transport Limited	)	(ie. part of NZBL Group)	25%
Cityline (NZ) Limited	)		25%
Newlands Coach Services Limited	)	(ie. part of Mana Group)	25%
Mana	)		25%

Shareholders in Infratil (who together hold approximately 10% of Infratil's shares (being interests associated with Lloyd Morrison and Liberato Petagna) also own 40% of Go-Bus Limited. Go-Bus is the operator of urban buses in Hamilton and school and charter buses in the Waikato region. Interests associated with Lloyd Morrison and Liberato Petagna control HRL Morrison & Co Group Limited. An associate company of HRL Morrison & Co Group Limited manages Infratil.

8 <u>Do any directors of the 'acquirer' also hold directorships in any other companies which are involved in the markets in which the target company/business operates</u>?

8.1 Please provide details of:

- *directors' names;*
- *the other companies;*
- *the markets involved.*

Liberato Petagna is a director of Go-Bus Limited and NZBL.

9 What are the business activities of each participant?

9.1 Please include a ***summary*** *of* ***all*** *the business activities of each participant* ***including all interconnected bodies corporate thereof and any other business identified in question 5.***

Acquirer

NZBL through Wellington City Transport Limited, Transportation Auckland Corporation Limited and Cityline (NZ) Limited operates bus services in:

- Wellington City excluding Tawa, Newlands, Paparangi, Churton Park;
- Lower Hutt/Eastbourne/Upper Hutt;
- Auckland.

Through Fullers Group Ltd it operates ferries in Auckland.

Target

Mana operates:

(a) Suburban bus services in Porirua City;
(b) Suburban bus services in Kapiti up to and including Waikanae;
(c) Suburban bus services in Newlands, Johnsonville and Churton Park and to Wellington CBD;
(d) A limited suburban commuter bus service from Waikanae and Paraparaumu to Wellington CBD (3 bus services in the morning plus evening returns);
(e) A limited suburban commuter bus service from Porirua to Wellington CBD (3 bus services in the morning plus 2 evening returns);
(f) Bus and coach charter services;
(g) Coach tour services principally for Kirra Tours (a package coach tour operator) and for cruise liners calling at Port Wellington.

Joint Company

Wellington Integrated Ticketing Limited facilitates some limited integrated ticketing, being a monthly pass and a day pass.

10 What are the reasons for the proposal and the intentions in respect of the acquired or merged business?

The other shareholders wish to sell out of Mana and have approached NZBL to see if it was prepared to purchase. These other shareholders have indicated that they prefer a sale by private treaty rather than a promoted tender. Also, with NZBL already owning 26% of Mana, with rights of pre-emption, it was in a preferred purchase position.

[

]

Common ownership will make it significantly easier to introduce integrated ticketing and better scheduling for passengers who require to travel on both Mana and Stagecoach as part of their journey.

NZBL intends to continue to operate Mana under its existing brand names and as a separate division of the combined entity.

The acquisition will also give NZBL access to the coach market, a market it has not hitherto been involved in within New Zealand.

PART II: IDENTIFICATION OF MARKETS AFFECTED

HORIZONTAL AGGREGATION

11 <u>Are there any markets in which there would be an aggregation of business activities as a result of the proposed acquisition</u>?

11.1 Are there any markets in which the acquirer (and/or any interconnected or associated company as identified in questions 5.1.1 or 5.1.4), and

11.2 The business to which the assets relate, ***or***

11.3 The 'target company' (and/or any interconnected or associated company identified in questions 5.2.1 and 5.2.2 above) are both engaged?

11.4 Please identify for each market:

- *product(s), functional level, geographical area;*
- *the specific parties involved;*
- *the relationship of those parties to the acquirer or target company as the case may be.*

<u>The Markets</u>

(a) As noted, NZBL considers that the relevant markets are:

(i) the provision of personal transport services in the greater Wellington region (divided into the five geographic regions noted);
(ii) the provision of bus charter services in the Wellington region; and
(iii) the provision of coach charter tour services through the North Island.

(b) That is:

1. In relation to (i), NZBL contends that users of buses have other options which are directly substitutable.

2. In relation to (ii), it is wide enough to encompass all charter services including school buses charters.

<u>Traditional Commission Analysis</u>

(c) In Decision 318, on an application by NZBL in respect of the proposed acquisition of Yellow Bus Company in Auckland, the Commerce

Commission, at paragraph 60 of the Staff Report, defined the relevant markets as:

- *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;*
- *the provision of bus charter services in the greater Auckland metropolitan region.*

(d) The Commission then concluded that the last two markets remained contestable but was not satisfied as to the first market so defined by it. Then, in Decision 326, the Commission, at paragraph 130, concluded that the key relevant markets were:

- *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.*

(It accepted that there was extensive competition in the school bus and bus charter markets that would not change with the merger and, so, did not need to be focussed on.)

(e) A similar approach was then taken in the subsequent decisions, Decision 460 (NZBL/Wellington Regional Rail Ltd/Tranz Metro (Wellington)); Decision 467 (Red Bus Ltd/Leopard Coachlines Ltd); and Decision 551 (also Red Bus Ltd/Leopard Coachlines Ltd). Essentially the Commission then considered that there are 3 markets:

- the commercial services rights market;
- the urban bus subsidies market;
- the school bus rights market.

That is, the Commission rejected a wide definition and, further, saw a separate market for "*tendering*" (eg. paragraph 125 of Decision 326).

Position of NZBL

(f) If the Commission is not prepared to consider a personal transport services market then NZBL says the relevant markets are:

(i) The provision of (or right to provide) scheduled bus passenger services in the City of Wellington excluding Tawa, Newlands, Johnsonville, Paparangi, Churton Park (for present purposes "**Wellington Central**");

(ii) The provision of (or right to provide) scheduled bus passenger services in the Tawa, Newlands, Johnsonville, Paparangi, Churton Park and to Wellington CBD (for present purposes "**North Wellington**");

(iii) The provision of (or right to provide) scheduled bus passenger services in the Porirua, Titahi Bay, Whitby, Paremata & Plimmerton (for present purposes "**Porirua**") with limited services to Wellington CBD;

(iv) The provision of (or right to provide) scheduled bus passenger services in the Kapiti coast (principally Raumati, Paraparaumu & Waikanae) (for present purposes "**Kapiti**") with limited services to Wellington CBD;

(v) The provision of (or right to provide) scheduled bus passenger services in the Hutt Valley (including Wainuiomata and Eastbourne) (for present purposes "**the Hutt Valley**") with services to Wellington CBD from Eastbourne and otherwise limited services to Wellington CBD;

(vi) Rights to operate subsidised bus passenger services in Wellington Central;

(vii) Rights to operate subsidised bus passenger services in North Wellington;

(viii) Rights to operate subsidised bus passenger services in Porirua;

(ix) Rights to operate subsidised bus passenger services in Kapiti;

(x) Rights to operate subsidised bus passenger services in the Hutt Valley;

(xi) The provision of school and bus charter services in Wellington Central;

(xii) The provision of school and bus charter services in North Wellington;

(xiii) The provision of school and bus charter services in Porirua;

(xiv) The provision of school and bus charter services in Kapiti;

(xv) The provision of school and bus charter services in the Hutt Valley; and

(xvi) The provision of coach services in the Greater Wellington Region.

<u>Geographic Market</u>

(g) That is, NZBL considers that there are distinct geographic regions within Greater Wellington which create their own geographic markets. This geographic division is explained more fully in the Introduction but arises because:

- the topography of Greater Wellington;
- the restrictions on buses competing with the urban rail service (with the result that a very large percentage of bus journeys are confined within each geographic region);
- historical reasons;
- the nature of a passenger bus operation;
- the conditions of entry;
- the exposure of incumbents.

(h) The fact that NZBL already operates in two of these five geographic markets does not mean that they are the same market (otherwise the Auckland market would also have to be added because NZBL also operates in that market).

(i) The Commission has recently considered whether each route and each service on that route could be a separate geographical market (Decision 551 paragraph 84). In this case, the Commission decided to group similar routes together and analyse them as if they represented a single market. The Commission did, however, recognise that Christchurch and Timaru were local economies and thus separate markets (paragraphs 86 & 87).

(j) NZBL contends that this analysis should apply in this instance. While, Wellington Central is not the same distance from Hutt Valley or North Wellington as Christchurch is from Timaru the combined effect of, especially, the geography, the lack of overlapping routes and the GW restrictions on competing with urban rail services make the situation highly analogous. The same is true as to why North Wellington, Porirua and Kapiti are separate markets. The distances between these regions are sufficient that it is not economic for an operator to service one region from another. Also, there is little demand from bus passengers to travel between these regions (and between Kapiti and Porirua the only option is train). Most importantly, GW's transport strategy is to use buses as feeders for the trains so routes are designed to bring passenger to rail stations rather to go between regions.

(k) Bus passengers in the greater Wellington region make a very large percentage of their bus journeys <u>within</u> one of these five geographic markets. The only significant exceptions are the Eastbourne-central Wellington and Newlands-central Wellington services that exists because travellers from the Eastbourne and Newlands (and to a lesser extent Churton Park) area do not have seamless access to urban rail. For Eastbourne travellers, the ferry service is insufficient for their needs.

(l) The Commission has previously considered that because Environment Canterbury's objective is to provide an integrated network of bus services to its constituency that it was appropriate to define the market in broad geographic terms, notwithstanding that passengers do not regard different bus routes as substitutes for each other (Decision 467 paragraph 106). This approach is clearly differentiable from the present case as GW's policy is not to provide an integrated network of bus services in the greater Wellington region. To the contrary, GW's policy is to create an integrated public transport network for greater Wellington with bus and urban rail being substantially mutually exclusive on key commuter routes.

(m) As a consequence, there is only a small geographical overlap between the services of NZBL and Mana. In particular, they only compete with each other (and Tranz Rail) for passengers on the unimportant (in terms of new passengers) Ngauranga to Wellington CBD sector (with NZBL being heavily constrained as to the number of buses they can run on that route). There is then the more densely trafficked route to Courtenay Place. However, even then there is little competition in practice. The Mana buses are essentially completing a "long distance" (in urban bus service terms) journey and their concentration is on completing that journey rather than picking up passengers for short trips (with all the delays that go with that). Even when they do stop prospective passengers will not normally consider them as substitutes because:

(i) They may be wishing to go further than Courtenay Place; or

(ii) They will be waiting for a bus for which they directly hold a ticket (because of other journeys); or

(iii) If casual customers (as opposed to ticket holders), they will simply board the first bus to arrive.

(n) It should also be recognised that the Porirua services to Wellington CBD and the North Wellington services that come through Churton Park and Johnsonville are viewed by GW as means of alleviating peak hour capacity problems on, especially, the Johnsonville train line and to provide those passengers that wish to travel well beyond Wellington railway station with some choice.

(o) Head to head competition is, in fact, very rare in the urban scheduled bus passenger industry worldwide. The Commission, in Decision 318, at paragraph 75 commented:

> *Our investigation suggested that there are few bus routes in Auckland (commercial or subsidised) which are capable of supporting more than one bus operator on a profitable basis. As a result, bus companies compete directly with each other to only a relatively limited extent on common routes.*

NZBL would go further and say there are none, at least in the Wellington region, and that common routes competition is extremely limited geographically and, even there, in terms of actual rivalry.

(p) The long history of NZBL not tendering for subsidies in the North Wellington, Mana and Kapiti and Mana Coach not doing so in either Wellington Central or Hutt Valley reinforces the view that the markets are separate. (The only times where they have competed for tendered contracts has been in the extremely limited occasion when some very minor cross border routes were put out to tender)

(q) It is not relevant for market definition purposes that GW is the subsidy provider in all three geographic markets. The same competition issues would arise if the subsidy provider in North Wellington was a separate regional council. Moreover GW also covers the Wairarapa but that is clearly a different geographical region. The same applies to the geographic regions defined in this application.

(r) In relation to the Commission's various product/functional definitions NZBL comments:

(i) Most school bus services are scheduled services. The principal differences are that they use older buses and are let in small parcels, thereby opening up the greater possibility of entry by a small operator;

(ii) The essence of the first market definition is "*scheduled bus passenger services*". NZBL notes that, in this context, there is competition with other public transport providers such as trains and with those taxis which do run mini-bus services and with shuttle services and taxis generally. There is also competition from the Cable Car. To the extent that buses are permitted to take passengers from Eastbourne or Petone to Wellington there is also competition from the ferries ;

(iii) Even if cars are not sufficiently substitutable to justify a wider market definition (not accepted) there is still a substantial degree of substitution (as the Tauranga experience and Christchurch research reveals – see Appendix), which adds to the constraints exercised by GW. NZBL cannot increase fares without the consent of GW and, even if it does get that consent, risks losing patronage to alternative transport means. Similarly, if NZBL attempts to lower quality, not only will it be in breach of its contract with GW, it risks the backlash of a loss of custom. These features mean that it does not have market power in the bus passenger services market. The merger will not change that.

<u>Bus Subsidies Market</u>

(s) Within the so called bus market are 2 types of subsidies offered by Greater Wellington Regional Council:

- subsidies for the operation of trolley buses;
- subsidies for the operation of other contracted bus services.

(t) NZBL is the sole owner, within New Zealand, of trolley buses. It is impractical to have more than one operator of trolley buses. The subsidy for this operation is let as a single contract, is <u>not</u> tendered and is resolved by negotiation. There will be and can be no change in relation to this as a result of the merger on any realistic counterfactual.

(u) In relation to the contract services these are tendered on a geographical basis (eg. all Seatoun routes). Such grouping of tenders is consistent with the geographic markets set out by NZBL.

(v) As a consequence, tender history shows that NZBL and Mana do <u>not</u> compete. Following each tender round GW is obliged to publish the number of tenders received and the highest and lowest tenders. It is readily apparent from that this NZBL and Mana are not competing. Nothing will change as a result of the merger.

(w) It has also been the experience of NZBL in the Auckland region that competition at tendering time is generally very limited, at least amongst the larger, well established operators. The Commission, in Decision 326, at paragraph 147, comments:

> *Historically, bus companies in the [Auckland] market have confined operations to their own districts and competed only at the fringe.*

(x) Because of:

- Wellington's topography;

- the constraint on competing with the urban rail network;

- the buffer zones between the area where Mana operates and the areas where NZBL operates being primarily residential or commercial without industrial land suitable for depots,

there are virtually no real fringe areas. The only possible exception could be parts of North Wellington where Mana might be able to compete with NZBL from its Newlands depot (although the Newlands depot is currently constrained and would require some reconfiguration). This theoretical possibility would, however, be a very minor portion of the total operations of both companies and is a one way operation because NZBL does not have (or require) a northern depot from which it could compete with Mana.

(y) This would not stop a new entrant obtaining a strategically placed depot inside the relevant geographic area. It is just that Mana is no better placed to do that than any other new entrant;

(z) In the 2 Auckland decisions the Commission downplayed the prospect of new entry from outside because of the threat of retaliatory action. (See Decision 318 at paragraph 91 and Decision 326 at paragraph 186.) NZBL says that these particular comments on retaliatory action do <u>not</u> apply to new entrants into the bus subsidy market, at least not now in Wellington, because of the terms on which GW registers commercial services and lets tenders. However, adjacent incumbents do not enjoy any special ease of entry into the other's market. There is also a perception as to a different type of retaliation. That is, if a neighbouring or other incumbent is considering attempting to undercut its neighbour in other than fringe areas it may factor in the risk that, if successful, it will face retaliatory action within its own area next time round. This perception arises because of the adverse impact on profitability of a loss of some routes and because the other player will have surplus buses.

<u>Bus Charter Market</u>

(aa) The same geographic issues apply in the bus charter market but with the additional feature that NZBL is in a substantially different part of the bus charter market. It does not have the same quality of coaches as the Newlands part of Mana and, therefore, does not compete for "quality" charter services (such as tours for passengers from visiting cruise ships or corporate business). Nor do its buses have space for luggage thereby limiting the types of charter. At the lower end of the market, where urban commuter buses are more suitable, the charters are very localised (eg. local schools). Here, NZBL and Mana have some similar buses. However, given the wide geographical separation, there is no real existing competition;

(bb) Further, the barriers to entry are low. This was accepted in relation to this particular type of market in Decision 551 at paragraph 284 and in Decision 326 at paragraph 74. The same situation applies in Wellington;

<u>Coach Market</u>

(cc) As to the other market identified by NZBL (the market for provision of coach tour services) NZBL does not have any current involvement in that market nor does it have the appropriate vehicles. Accordingly, there is no aggregation here.

Differentiated Product Markets

12 Please indicate whether the products in each market identified in question 11 are standardised (buyers make their purchases largely on the basis of price) or differentiated (buyers make their purchases largely on the basis of product characteristics as well as price).

The market is a differentiated market as buyers decide to "purchase" particular modes of commuter travel (car, taxi etc.) for reasons other than just the immediate price.

13 For differentiated product markets:

13.1 Please indicate the principle (sic) characteristics of product that cause them to differentiate from one other;

13.2 To what extent does product differentiation lead firms to tailor and market their products to particular buyer groups or market niches;

13.3 Substitutes;

13.4 Given the level of product differentiation, to what extent do you consider that the merged entities would be constrained in its actions by the presence of other suppliers in the market(s) affected?

(a) The buyers purchase on what is the total trip cost. This incorporates not only the cash costs of the different modes but also:
- travel;
- time costs (including walking and waiting time at each end of the trip);
- parking costs;
- frequency of service;
- reliability; and
- "comfort" factors.

(b) Most households own at least one car. The decision whether or not to use a scheduled bus passenger service depends on many factors, including the marginal costs of using the car on that day. Overseas research (eg. David Starkie obtained by the Commission in the course of investigation leading to Decision 318), showed that for a 10% rise in bus travel costs 8.3% of patronage will fall and switch to cars. That was in an area with only 66% household car ownership. Wellington will have a significantly higher level of ownership;

(c) Even if a car is not owned the cost of acquiring a used Japanese import is not high;

(d) The substitutability of bus for car is seen from existing NZBL advertising on its buses;

(e) In its various Decisions the Commission applied the "*ssnip*" test to reach a narrow definition of the market. In respect of that NZBL says:

(i) Although useful the test is simply a tool. It does not have the force of law;

(ii) The test should be a 5% increase in the total cost of the journey viewed from the point of view of the passenger rather than of just a fare. That is, the disadvantages and discomforts of a fixed time service (rather than convenience of the alternatives of private car, walking, taxi) running from fixed point to fixed point need also to be costed in. That is, the test is looking at both supply side substitution <u>and demand side</u>. It is inappropriate when considering the demand side substitution to consider the 5% to apply to only part of the demand side immediate "cost". The approach of the Commission in Decision 326 was inconsistent in that it ignored these other costs when applying to the SSNIP test yet, when discounting the attractiveness of the use of the personal motorcar, took into account parking and time delays from congestion (see paras 67 v 100. Note also paragraph 29);

(iii) Given the high percentage of car ownership and all the fixed costs that go with that, the comparison should be with the <u>marginal</u> cost of additional car travel;

(iv) Marginal revenues are important to the bus operator. That is, a small loss of patronage does not allow cost reductions and can have significant impact on profit;

(f) It is important to recognise that a bus operator cannot discriminate between users who are highly sensitive to fare and service trends and those who are not;

(g) The merged entity will be able to offer some integration of bus routes. However, the new entity will still face the problem that bus time entails journeys that are only undertaken at scheduled times, are longer because of the intermediary steps and the need to walk at either end. Compare that with the alternative of the car giving a single journey direct from the person's home.

VERTICAL INTEGRATION

14 Will the proposal result in vertical integration between firms involved at different functional levels?

14.1 Is the "acquirer" (or any interconnected or associated company as identified in question 5.1.1 – 5.1.4) and:

- *the business to which the assets relate,* ***or***
- *the 'target company' (or any interconnected or associated company as identified in question 5.2.1 and 5.2.2)*

engaged at different functional levels of the same product market(s)?

14.2 Please identify for each market:

14.2.1 products, function levels, geographic areas;
14.2.2 the specific parties involved;
14.2.3 the relationship of those persons to the 'acquirer' or 'the target company' as the case may be.

14.3 If so, in all subsequent questions about markets affected by the proposal, please give details of both (or all) the downstream/upstream markets concerned; and details of existing vertical links between the participants (and/or interconnected or associated companies) in each of these markets, eg supply agreements, long-term supply contracts.

No.

15 In respect of each market identified in questions 11 and 14 identify briefly:

15.1 All proposed acquisitions of assets of a business or shares involving either participant (or any interconnected body corporate thereof) notified to the Commission in the last three years and, in each case;

15.1.1 the outcome of the notification (eg, cleared, authorised, declined, withdrawn);
15.1.2 whether the proposed acquisition has occurred.

None.

15.2 Any other acquisition of assets of a business or shares which either participant (or any interconnected body corporate) has undertaken in the last three years.

None through NZBL.

PLEASE ANSWER QUESTIONS 16 - 26 BELOW IN RESPECT OF EACH MARKET IDENTIFIED IN QUESTIONS 11 - 14

PART III: CONSTRAINTS ON MARKET POWER BY EXISTING COMPETITION

Existing Competitors

16 In the market or markets who are the suppliers of competitive goods or services including imports?

16.1 Please identify their owners (including ultimate owner/s).

16.2 What are their estimated shares both in terms of productive capacity and of sales?

- *give the total size of the domestic market;*
- *identify at least the four leading suppliers;*
- *include participants to this proposal;*
- *identify imports clearly (including country of origin and the importers);*
- *identify source(s) of estimates;*
- *note that competitive goods may not be confined to identical or branded goods.*

(a) On the basis of the 5 geographical markets, and looking only at buses, the markets are divided as follows:

Wellington Central

	Supplier	Owner	Share of Productive Capacity	Estimate of Market Share
1.	Stagecoach	NZBL	-	99%
2.	Shuttle vans	various	-	1%

NorthWellington

	Supplier	Owner	Share of Productive Capacity	Estimate of Market Share
1.	Newlands/Mana	Mana	-	99 %
2.	Shuttle vans	various	-	1%

Porirua

	Supplier	Owner	Share of Productive Capacity	Estimate of Market Share
1.	Newlands/Mana	Mana	-	98%
2.	Tranzit Coachlines	Snellgrove Family		1%
3.	Shuttle vans	Various-		1%

Kapiti

1.	Mana Mana		-	94%
2.	Madge Motors	Allen Family	-	5 %
3.	Shuttle vans	various	-	1%

Hutt Valley

1.	Stagecoach	NZBL	-	93%
2.	Classic Coaches	R Potts	-	5 %
3.	Community Coach Services	Hutt Taxis (a driver co-op)	-	1%
4.	Shuttle vans	various	-	1%

(b) In relation to the North Wellington market Mana also competes directly with Tranz Metro for passengers travelling to and from Central Wellington. This will not change with the proposed acquisition.

(c) If, however, the wider product/functional market is accepted the shares of NZBL and Mana in their respective markets reduces to under 10%, with Tranz Metro taking about 5%, taxis also about 5%, private motorists about 78%, and the balance made up of the other listed players.

16.3 Please indicate the source of the data provided and where they are estimates, the likely degree of accuracy.

(a) In Wellington the buses carry about 10% of total personal passenger transport and 20% - 25% of the morning commuter traffic. Within that percentage the market share of the bus companies is based on the estimated number of buses owned by the larger companies, namely:

- NZBL has about 169 buses in the Hutt Valley;
- NZBL has about 205 buses in Central Wellington;
- Mana has about 98 buses in the region (apart from long distance coaches);
- Tranzit has about 100 buses overall based in the lower North Island but with only approximately 2 currently operating locally in the Wellington region;
- Community Coach Services currently operates 2 small buses;
- Classic Coaches is operating 7 buses in the Wellington region.

(b) Based on official data it is calculated that taxis carry about 49% the number of people that the buses do, although the taxis themselves claim that they carry as many passengers in the Wellington region as the buses and are insistent on sitting on the GW committee aimed at increasing the attractiveness of public transport;

(c) Commuter rail is estimated at 5% of passenger numbers, its head count being about 60% of NZBL. However, the number of passenger miles will be higher;

(d) The other figures are based on estimates.

16.4 Where available, please provide data in the form of the table above for any or each of the past 5 years, as well as for the most recent year.

There has been little change over the last 5 years other than:

- Classic Coaches and Madge Motors have entered their respective markets;

- Blue Penguin (with less than 1% share) exited the Hutt Valley market on the death of its owner, D Tarr;

- South Bus (again less than 1%) has withdrawn from the Hutt Valley market with its routes being taken over by Classic Coaches.

Other Considerations

16.5 Please identify any firms that could enter the market quickly (using essentially their existing productive capacity) in response to an attempt by suppliers to raise prices or reduce output or quality (new entrants).

(a) In the various scheduled bus passenger services markets possible new entrants include:
- Tranzit Group in Palmerston North which is known to be watching the market;
- Ritchies Coachline who operate city buses in Auckland and Timaru and coaches and school buses nationwide. Ritchies has recently expanded in North Shore. Ritchies management has moved to the next generation of that family, which generation is showing a more aggressive approach to expanding into other territories;
- Madge Motors based in Palmerston North who now have a contract (from GW) for services between Otaki and Paraparaumu and whose buses do come into Wellington on charter. The principals of Madge have indicated to third party suppliers that they are prepared to compete in the Wellington region on a larger scale at the next GW tender period;
- Pavlovich which operates in Auckland as Urban Express. Pavlovich expanded in Auckland up to 2003 and has been

attempting to expand outside Auckland, eg. by tendering for contracts in Hamilton;

- Red Bus Ltd;
- Invercargill Passenger Transport (who operate school bus and tour buses services around the country and who has previously tendered in Wellington);
- Murphy's in Pukekohe and South Auckland;
- Howick & Eastern;
- Birkenhead;
- Nimbus in Napier/Hastings;
- Okato in New Plymouth;
- Any taxi company;
- Any coachline operator;
- Any of the overseas companies listed in 16.7 below.

(b) Some of these may not currently be interested in moving out of their existing geographic location. However, experience shows some are actively seeking to expand while others may be forced to if they lose contracts in their existing locality. An example of that was Total City Buses who lost tenders in Auckland, moved to Palmerston North, lost tenders there and moved to Whangarei.

(c) Mana has advised NZBL that it expects Madge Motors to tender more aggressively in the Kapiti region during the next round of tenders.

(d) The threat of new entry is an effective restraint on incumbent operators. Because the incumbent operator can not know whether a particular tender will be contested then if it is aware of a potential competitor then in its own tender needs to take that threat into account, whether or not it materialises.

16.6 <u>Estimate the productive capacity that such new entrants could bring to the market</u>.

This is difficult to estimate but approximate numbers are:

Ritchies Coachline	600 buses
Tranzit Group	250
Madge Motors	90
Pavlovich	35
Classic Coaches	7
Red Bus Ltd	180
Invercargill Passenger Transport	150
Murphy's	80
Howick & Eastern	80
Birkenhead	50

Nimbus	50
Okato	20

16.7 Please indicate the extent to which imports provide a constraint on domestic suppliers.

(a) The constraint here arises from the risk that the GW will actively seek overseas bus companies to tender for subsidised services, especially if they have previously shown an interest in New Zealand;

(b) Some overseas bus operators have shown an interest in entering New Zealand (many of whom now operate on the eastern seaboard of Australia). They include:

- Connex, a world wide bus and rail operator (including bus fleets in Sydney and Perth) and operators of the Auckland Metro rail system;
- Trans Dev, also an international bus and rail operator (including buses in Sydney and trams in Melbourne);
- Grenda (see (c) below);
- Pacific Transit Group (including Swan Transit and Torrens Transit (see also (c) below);
- National Express;
- Busways (operating buses in Sydney);
- Comfort Delgro (see (d) below);
- Serco (who run the Cable Car in Wellington and have other New Zealand interests);
- Keffords, another large Melbourne bus operator;
- Kowloon Motor Bus, the largest bus operator in Hong Kong;
- New World City Bus, the other main Hong Kong bus operator (see (e) below);

(c) Pacific Transit operate in Adelaide and Perth, Grenda operate in Adelaide, Perth and Melbourne. At the recent Victoria Bus & Coach conference the 2 principals (Neil Smith and Scott Grenda respectively) were heard to say that they were interested in attacking Stagecoach in New Zealand. As will be apparent, those comments have been reported to NZBL. Accordingly, when tendering, NZBL must factor in this possibility as it will not be sure whether or not that attack will actually materialise. Swan Transit (part of Pacific Transit) did tender in the Auckland North Shore in 2004 against Stagecoach but lost out to Ritchies;

(d) Comfort Delgro claim to be the world's second largest road passenger operator. It is a large bus operator based in Singapore and has the stated aim of expanding its non-Singapore operations so that they at least equal its Singapore operations. Comfort Delgo has recently acquired Westbus in Sydney;

(e) New World City Bus is a recent amalgamation of 2 large Hong Kong bus operators, one previously owned by Stagecoach. It is known that they are interested in expanding.

16.8 <u>To what extent is the product exported</u>?

"Product" as such is not exported.

16.9 <u>Please indicate whether "the target company" could be described as a vigorous and effective competitor, taking into account its pricing behaviour, its record of innovation, its growth rate relative to the market, and its history of independent behaviour</u>.

As noted, Mana does <u>not</u> compete with Stagecoach.

Conditions of Expansion

17 <u>The following listing gives different types of market conditions that may affect the ability of existing firms to expand</u>:

17.1 *Frontier entry conditions*

eg, tariffs, quarantine requirements, international freight costs;

17.2 *Legislative/regulatory conditions*

eg, meat licensing, Resource Management Act requirements, health and safety standards.

17.3 *Industrial/business*

eg, access to raw materials, critical inputs, economies of scale, access to technical knowledge requirements, capital requirements (and capital market's perception of the risk and return), sunk costs (ie, irrecoverable or exit costs), influence of branding, technical specifications.

17.4 *Other eg. responses to expansion by major firms; lack of additional productive capacity; additional productive capacity has a relatively high costs.*

Which, if any, of the conditions identified above do you consider could be likely to act as a barrier to expansion by existing competitors where they have the incentive to do so in response to a sustained effort by the combined entity to raise price, or to lower service or product quality?

(a) NZBL does not accept the Commission's past approach that barriers to entry are substantial. Importantly, however, the same "barrier" applies to Mana (in competing with NZBL) and NZBL (in competing with Mana) as to any other potential entrant. Neither Mana nor NZBL enjoys any special advantage because of geographic proximity and because of their respective exposure to retaliation in the one fringe (parts of North Wellington) each may be at a disadvantage compared with an entirely new entrant such as an overseas operator or a coach company;

(b) In relation to scheduled bus passenger services, first it has to be recognised that "sustained effort by the combined entity to raise price or to lower service or product quality" is not feasible because of the constraints imposed by GW (in addition to the customers themselves). Fare increases are prohibited without consent (hard to obtain and with the possibility that the benefit, in relation to contract services, will go back to the Council at GW's discretion). GW also imposes quality standards on contracted services. In practical terms these constraints also apply to commercial services with the potential to encourage competitive entry in respect of services now covered by commercial services by letting (subsidised) contracts for that service. There is also the real risk of loss of passengers;

(c) The countervailing power of GW makes raising of prices extraordinarily difficult in the bus subsidies market as witness the very difficult negotiations over the trolley buses and absence of any increase there;

(d) In circumstances where there is only one tender received by GW it is usual for GW to negotiate the final outcome before awarding the tender. The negotiations might cover extending the hours or frequency of service within the same tender price. If GW is not satisfied with the final negotiated outcome then it can retender the contract and make a special effort to encourage a new entrant. To date, GW has not found its necessary to do this. Clearly it is for GW to confirm, but NZBL believes that retenders (where there has only been one tender) are not called because GW considers that it can achieve a satisfactory outcome through negotiation and the threat of retender.

(e) That aside, it is considered that there are no significant barriers to new entry:

    (i) There are no frontier entry conditions;

    (ii) The only regulatory conditions are:

        a. A licence under the Transport Act which is easily obtained. This is provided the applicant does not have a criminal record of significant convictions under the Transport Act itself, is not a bankrupt and can demonstrate a familiarity with the legal requirements;

b. Registration of the proposed service with the Regional Council – see s.49 of the Transport Services Licensing Act 1989. There are only limited grounds on which the Council can decline to accept registration. One reason is the impact of the service on existing contracted services;

(iii) There are no industrial or business barriers. There are a significant number of second-hand city buses readily available, especially for an overseas operator who can import such buses. Although GW specifies a maximum average age of fleet, GW does not require new buses and the modifications to imports required for the New Zealand market are not significant. Ritchies recently won tenders in Auckland requiring approximately an extra 60 buses of business. It was able to meet that demand both by importing buses from overseas and with some new buses. Both new and second-hand buses can be subject to an option before tendering with finance readily available for both. Lead in times for new tenders allow for a significant number of new buses to be built before the new contracts become operational. (Note the comments by Designline recorded at paras 50 and 51 of Decision 467.) Of course, NZBL needs to have a similar number and mix of buses which, of their very nature, need to be replaced from time to time. The fact that NZBL has an existing fleet of buses would not permit it to earn supra-normal profits in the long run. The need to acquire buses (which are available given time and resaleable on exit) is no more than a commercial challenge and not a barrier to entry (to use a phrase used by the High Court in Telecom v Commerce Commission (1991) 4 TCLR 473 at 522). Further, buses are available on lease. Provided one has access to buses (eg. under an option) it is not necessary to own the buses in advance of lodging a tender for contract services. The buses can be easily resold, if one wishes to exit the market or, alternatively, used to tender for services in another locality. There is a ready market for used buses with established secondhand bus dealers. Leopard, for instance, has sold some of its buses to NZBL and to Mana. It is also possible for a regional council to itself acquire buses and lease them to the successful tenderer;

(iv) To start a commercial service just requires the bus, driver and some limited infrastructure. Most fares are paid in cash. Concession tickets yield cash ahead of use so working capital requirements are low;

(v) Although a bus depot is required these are easily obtainable on industrial land. GW is able to temporarily adjust contract terms to allow a new contractor to operate from temporary premises and with a non-complying fleet of buses should extra time be required for the contractor to acquire permanent premises and fleet. A depot is, of course, a tangible asset that can be realised when and if the participant exits the market. It can also be leased. The costs of establishing a depot in Wellington Central is likely to be much higher than in Kapiti as land costs are much higher. That is not a barrier to entry but simply a cost of doing business in a particular market. The cost is the same for a new entrant and an incumbent operator – who needs to apply a similar amount of capital to have a depot;

(vi) The GW Council has the interest in, the ability, and the statutory obligation to organise tender rounds in a way which promotes competition. That was always so but has been reinforced by the Land Transport Management Act 2003, s.25. The manner of letting tenders is currently under review following the passage of that Act. It is expected that the tendering process will be altered in a way that will enable those contemplating large scale new entry to aggregate several parcels of routes. This can overcome the network effects referred to in, eg. Decision 551 at paragraph 175. The length of the contract period could also be extended;

(vii) Computerised scheduling packages are easily available on a bureau basis;

(viii) Knowledge of the Wellington market is well within the research capabilities of existing operators. The routes and timetables are public information. The price at which previous tendered routes have been let are publicly available and would help to provide a guide to a new entrant. Physical observation of actual numbers is not difficult and can be done using low cost labour. Before it acquired Yellow Bus Company NZBL did exactly that. NZBL considers that the Commission has over emphasised this aspect of entry barriers. In any event Mana will face the same problem;

(ix) GW can also overcome any concerns about lack of patronage information by offering subsidised contracts on a gross basis (ie. the regional council keeps the fares). Waikato has recently done that and Auckland Regional Transport Authority is looking at that. It can also amend its contracts so that, for the future, patronage information ceases to be confidential.

18 <u>Please name any businesses which already supplies the market – including overseas firms – which you consider could increase supply of the product/service concerned in the geographic market identified by any of the following means</u>:

- <u>diverting production</u> (into the market (eg. from exports))
- <u>increasing utilisation of existing capacity</u>
- <u>expansion of existing capacity</u>

Specify in each case which of the above three points applies.

In relation to the scheduled bus passenger services market any of the other named bus operators noted in the answer to questions 16.5 and 16.6(b) could expand existing capacity by acquiring more buses or transferring buses from other parts of their businesses elsewhere in New Zealand or overseas. Others from overseas in this category would include:

- First Group
- Go Ahead
- Ariva
- EYMS

19 Of the conditions of expansion listed above which do you consider would influence the business decision in each case to increase supply?

(a) There are no barriers to entry in the scheduled bus passenger services market so there are no adverse influences. The decision would be based on whether entering was likely to be profitable in the long term;

(b) However, a major company may well be prepared to take the risk of short term lack of profitability to obtain a presence on the national scene;

(c) If NZBL increased its prices or lowered its services such entry would be profitable. (However, a price and service change is only permitted with the consent of GW.)

20 How long would you expect it to take for supply to increase in each case?

Only a very short time span is required to set up a commercial service or a totally new contract service as and when the latter comes up for re-tender. This occurs on a rolling basis every year.

21 In your opinion, to what extent would the possible competitive response of existing suppliers constrain the merged entity?

(a) Bus operators are severely constrained by the prospect of competition from new entrants. This is illustrated by the existing levels of subsidy obtained by NZBL on its Wellington routes. This has significantly reduced over the period since deregulation. In the 12 months to 30 June 1991 (the then year end) the subsidies paid to WCTL by Wellington Regional Council amounted to [ ]. In the 12 months to 30 April 2005 (the current year end) the subsidies paid by WRC amount to [ ]. That is a reduction of over [ ] in nominal terms over almost 14 years while inflation has increased by over 32%. That is to say, subsidies have declined by 48% in real terms over that time, during which there has also been a very substantial increase in services;

(b) In Decisions 318 and 326 the Commission was sceptical as to the prospect of new entry and doubted the cost estimates provided by NZBL. It is, therefore, relevant to consider what has happened in the intervening 7½ years since then:

  (i) Pavlovich, a coach operator based in Mount Roskill who was one of the strongest industry critics of the NZBL application in Auckland and who claimed high entry barriers, shortly after that acquired new MAN Designline buses similar to those used by NZBL and has been successful in winning a significant number of routes from Stagecoach Auckland in the subsequent tenders of existing routes and the tenders of trial routes. This occurred from the outset of the Yellow Bus acquisition in 1998 but it escalated in 2003 when it made particular inroads in the south and central Auckland Isthmus tender round by winning routes off NZBL with a substantial impact on bottom line profit;

  (ii) Reesby who used to be the incumbent in Rotorua has lost <u>all</u> its business to Ritchies there as a result of a new tender round. That is, Ritchies entered that geographic market de novo. Reesby subsequently won back that market in a later round;

  (iii) In 2004 Ritchies, primarily a coach operator with some limited city buses (operated from diverse locations), succeeded in acquiring new routes requiring about 60 buses in a competitive tender round. All this was in the North Shore area;

  (iv) Total City Bus which used to be the incumbent in Palmerston North lost all its business to Tranzit as a result of a new tender round in about 1998. Tranzit acquired refurbished Japanese imports for this expansion. Tranzit was also successful in winning the bus business in Wanganui off the local taxi company who had used minibuses to service that area. Tranzit has acquired school bus contracts within the Wellington region (including from Stagecoach). It also runs coach services into Wellington. It has the potential to expand into this region and in 2001 told the Commission that it was interested in the Wellington market and monitors NZBL's performance every year;

  (v) In about 2000, South Bus has won school bus routes in Wainuiomata using old refurbished Japanese buses and second-hand city buses (estimated to cost about $25,000). Subsequently, because of performance issues, GW barred South Bus from participating in the next tender round;

(vi) Classic Coaches entered the market by successfully winning tenders for school bus routes in Wainuiomata and, later, also in Eastbourne;

(vii) Madge Motors previously a country school buses and charter operator, has recently won a tender for a service from Otaki into Paraparaumu and runs charter buses into central Wellington;

(viii) Bayline entered the Hamilton City market using new buses. This was by winning Regional Council contracts. It has since lost out to Go Bus Ltd, another coach operator. Go Bus retaliated against Bayline's entry into the Hamilton market by tendering for work in the Tauranga area. It has subsequently withdrawn from that area;

(ix) Leopard expanded rapidly in Christchurch by winning business off the incumbent although in later tender rounds has lost ground. It did not have the resources to sustain that entry;

(x) Christchurch Bus Services Ltd has successfully entered the Christchurch market in a sustained manner using new and second-hand buses;

(xi) Invercargill Passenger Transport already operates in the North Island (tour and charter buses) and has been expanding its Dunedin scheduled bus passenger service;

(xii) It is also relevant to note that new urban bus services have been started in each of:
- Nelson;
- Whangarei;
- Tauranga; and
- Blenheim (to a smaller extent),

illustrating that entry is feasible despite the alleged barriers of passenger information access costs (no statistics available), regulatory requirements and infrastructure needs.

(c) Coachlines have significant natural affinity with the urban bus sector of the market (given the obvious similarities). Practical examples are Leopard Coachlines, Pavlovich, Ritchies, Go Bus, Madge, Tranzit and Bayline. Any coach line could enter by either expansion or diversion;

(d) The Commission has downplayed new entry on the basis of doubtful profitability. However, there are very few economies of scale and scope. If then, an incumbent attempts to raise its tender price to a level which would suggest market power, then new entry would become profitable on even the Commission's approach.

22 Looked at overall, and bearing in mind the increase in market concentration that would be brought about by the acquisition, to what extent do you consider the merged entity would be constrained in its actions by the conduct of existing competitors in the markets affected?

(a) If the market is accepted as being the personal passenger transport market (as to which see the Appendix), there will be no effect as the market shares of each participant is minimal;

(b) If the geographical markets are accepted there is, again, no effect as NZBL and Mana operate in different markets;

(c) Even if neither (a) or (b) are accepted, the merger will still result in no substantial lessening in competition. This is in light of:

(i) the unlikelihood of head-on-head competition for bus passengers (as evidenced by worldwide experience);
(ii) the almost total lack of common routes;
(iii) the lack of competition between NZBL and Mana for contracted routes which lack stems from sound strategic reasons;
(iv) the threat of new entry;
(v) the countervailing power of GW.

It is proposed to expand further on points (iv) and (v).

Threat of New Entry

(d) In assessing the prospect of new entry by operators in other regions the Commission traditionally speaks to the other operators and makes the assessment after that. NZBL makes the following observations as to that process:

(i) Entry is most likely in the context of a tender round;

(ii) At tender time, the market is an Australasian one. That is, any bus or coach operator anywhere in New Zealand has the ability to lodge a tender as does a well resourced Australian operator;

(iii) Importantly, when NZBL is tendering it does not know the intentions of such other operators. It cannot talk to them. While NZBL can anticipate that Mana will not tender as it has not done so in the past and operates in a geographically distinct area, it cannot make the same assessment in respect of other operators;

(iv) The classic statement in this context is that in the QCMA case (1976) 8 ALR 481, 516:

> *It is the threat of the entry of a new form or a new plant into a market which operates as the ultimate regulator of competitive conduct.*

That is, it is the threat as perceived by the incumbent that is important, <u>not</u> what others tell the Commission. It is interesting that in Decision 551 (as in the earlier decisions) the views of the other operators is kept confidential. NZBL does not and cannot know what the competitors are thinking and cannot afford to assume that they will <u>not</u> enter;

(v) However, NZBL is aware (because it was part of the public record) that the staff, in a Memorandum dated 5 December 2001, informed the Commission that "*Tranzit Coach Lines keeps monitoring NZBL performance but wouldn't enter within the next 12 months*." Reference was then made to the necessary capital investment. Implicit is that Tranzit would enter if it thought there was adequate financial incentive to do so. As the successful tender prices are published, presumably Tranzit monitors those;

(vi) NZBL also notes that Pavlovich and Ritchies have become more aggressive in the Auckland region;

(vii) NZBL is aware of the specific stated intentions of Pacific Transit and Grenda and the general intention of Comfort Delgro and New World City Bus;

(e) It is also important to note that the issue is whether NZBL will have substantially increased market power as a result of the merger (the flipside of substantial lessening of competition). Such increased market power is exhibited in the power to charge more and give less (ie. to make super profits). If, then, NZBL tried to increase its prices (eg. the subsidy it seeks from GW) it runs the risk that:

- some other company may have also tendered; or

- GW will reject its tender and call for new tenders, perhaps repackaged to suit a rival bidder. It can also negotiate with NZBL; or

- on the next round Tranzit and anyone else monitoring its performance will be encouraged to bid. Given the frequency of tender rounds, its advantage would be transitory;

(f) The Government has recently announced significant new funding initiatives in the public transport area The prospect of such additional long term funding makes it more attractive for offshore operators to seek entry into New Zealand. (That was part of the reasoning behind the recent acquisition of NZBL by Infratil.)

Countervailing Power of Greater Wellington Council (GW)

(g) The influence of GW is all pervading. This influence arises from the GW's statutory role as the funder and regulator of public transport services in Wellington. GW's role in constraining "market power" is, accordingly, very real;

(h) At the time of "deregulation", in at least the major metropolitan areas the bus services were provided by municipal bus operations which (to the extent one accepts the Commission's market definition), enjoyed a local "monopoly". Even with "deregulation" the worldwide trend is towards the evolution of large bus companies and the avoidance of head-on-head competition;

(i) The legislation was drafted precisely with that in mind and sought to empower the Regional Councils and other funding agencies so as to be able to control large operators who could otherwise have substantial market power. See, for instance, s.26(3)(c) and (d) and s.27 of the Transit New Zealand Act 1989. In 2003 these provisions were replaced with even stronger provisions - see s.25 Land Transport Management Act 2003;

(j) The purposes behind the 2003 Act include more emphasis on public transport in order to improve access and mobility and to ensure environmental sustainability (see s.12(3)(c) and (e)). Note also s.35 which requires the needs of persons who are transport disadvantaged to be considered;

(k) Consistent with that, the Government has decided to commit further funding to roading alternatives (ie. public transport). The flipside of this is that the regional councils are expected to exercise greater power and control over the process for tendering subsidised services. Reviews are currently under way by both the Ministry of Transport and Land Transport New Zealand to put that into practice;

(l) The expectation is that councils will package routes and the duration of the contracts in a way that makes large scale new entry by, for instance, an overseas operator, even more feasible;

(m) Even before that tightening up occurred the Commission, in Decision 326, paras 231 and 232, accepted that, in relation to the Auckland market, the Auckland Regional Council had sufficient countervailing power to prevent the NZBL/Yellow Bus Company combination from being dominant. That would equally apply in Wellington;

(n) The existing strength of GW is borne out by the 2 trolley bus subsidy rounds that have occurred since deregulation. NZBL is the only New Zealand company with trolley buses. GW had no option but to negotiate with NZBL but eventually, in the first round, forced NZBL into what, for it, was the unpalatable position of a significant (20%) reduction in subsidy (refer paragraph A9 in Appendix). In the more recent round it has held that subsidy level despite increased costs (refer paragraph A11 in Appendix);

(o) Even before the recent changes the power of regional councils was supported by another Commission finding. In 1992 the Commission itself investigated what it then called the supply of scheduled public passenger services by land. The Commission came to the view that regional councils were in the position of a monopsony with strong countervailing market power. The Report concluded (at paragraph 63) that:

> *Transit and regional councils therefore have the power to ensure that transport operators compete.*

<u>Service Types</u>

(p) There are basically 2 types of services – the contracted services and the commercial services;

<u>Contract Services</u>

(q) GW is required to periodically put out to tender, contracts for the servicing of certain routes which are not provided by bus operators on a commercial basis. Individual bus companies then tender for these contracts by indicating the level of subsidy they will require to perform these services. In the past these contracts have been for a mixed duration of 3 to 5 years and have staggered expiry dates so that some come up for renewal every year. Further, there is a right vested in either party to terminate the contract on 3 months notice. Subsidised routes make up about 80% of the routes NZBL operates on in the Wellington region;

(r) Individual contracts are currently limited to about 20 buses, so as to encourage tendering by small bus companies but, because several contracts are often let at one time, there is the opportunity for larger companies to aggregate a number of contracts so that it is possible to set up a large operation or to significantly enlarge an existing one;

(s) As discussed above, it is expected that there will be a more ability to aggregate routes and to have a longer duration in order to attract new entry from major bus companies well able to enter a market in a sustained manner;

(t) If GW is concerned about the market power of the merged entity it has the power to repackage the tenders in a way which will encourage existing competitors to expand and new competitors to enter. This can be done by repackaging the duration or the numbers of contracts or by moving to "gross" funding contracts where GW receives the fare revenue and takes the risk of lack of patronage. GW can extend this process by actively soliciting new entrants if it believes this is necessary;

(u) GW does not have to accept the lowest tender (even quality weighted). If GW does not like the tenders received it can reject all and either go to a new tender (perhaps repackaged to encourage new entry) or negotiate;

(v) Not only does GW have countervailing power as the monopsony purchaser of subsidised services, it has the incentive to exercise that power. The funds it allocates to contract services are provided as to 48% from rates. If the merged entity sought to exercise market power to increase subsidies or to reduce services (and thereby increase road congestion and road usage) it is GW which suffers;

(w) The contracts specify the route, maximum fares, timetables, minimum bus standards and other conditions. In effect, GW controls both the price and the quality of the service. Once awarded, the service must run to schedule and run on time and the buses must be kept clean and other conditions fulfilled. The price to the passenger cannot be increased without approval from GW which increase will be required to be justified to the Council. Furthermore, under contracted services the Council itself can require a fare increase and keep the benefit;

(x) Breach of the contract terms can lead to monetary penalties being imposed and, in the more serious cases, cancellation of contract with the attendant cancellation of the regional council subsidy;

(y) Accordingly, once awarded, the successful contractor has no discretionary market power in respect of that service but still needs to provide a high level of service on the one hand to keep the subsidy and, on the other, to maintain patronage (ie. fares) in the face of competition from other forms of transport and from, for some passengers, the option of travelling on a slightly different route which is still within the same general locality, eg. by suburban rail which is owned by Tranz Rail. The successful contractor also has the incentive to innovate as, if it increases patronage, it keeps that extra revenue;

(z) When the contract services come up for re-tender there is a significant potential for competition for that tender. As set out above, entry barriers are low. One only needs to have a licence under the Transport Act (easily obtained) and access to a bus of a reasonable standard (eg. through an option or right to lease) to seek to win a tender with adequate time between the granting of the tender and its operative date to actually acquire the bus and put into place (if not already possessed) the other things necessary to perform the service (basically only staff and a minimal depot facility which are not difficult to obtain). All bus operators are entitled to access to bus stops and terminals;

(aa) There is no necessity that those who tender need be an existing Wellington operator – for instance, an operator from another centre (eg. Palmerston North or anywhere else in New Zealand) could seek to enter, as could a newcomer to the industry, as has happened in Wellington, Palmerston North and Christchurch. An international operator could also enter;

(bb) In the event of there being no competition for a service contract the GW has the right to negotiate on price with the tenderer and/or re-tender the contract;

Commercial Services

(cc) Apart from those scheduled services which operate under contract from GW, there are a small minority of scheduled services which operate on a commercial basis (albeit with concessionary fare subsidies from GW). These amount to about 20% in Wellington Central and 25% in the Hutt Valley;

(dd) There are no significant barriers to entry into a market for commercial services. A transport licence is easily obtained, there are a few quality controls and there is a ready stock of suitable second-hand city buses with leasing facilities also available. A secondhand bus could be acquired for as little as $25,000, with better quality buses available at $100,000. Even if the higher price is paid (as was suggested in Decision 551 (which appeared to be looking at a new bus rather than a second-hand bus) that cost is still not high and the asset can be realised if the firm exits the market (ie. it is not a fixed or sunk cost). A passenger service is required to be registered with the regional council but the grounds on which the regional council can decline registration are strictly limited and do not include the impact on a competing commercial service – see s.49 of the Transport Services Licensing Act 1989;

(ee) If the regional council is dissatisfied with the commercial service offered, whether on price or frequency or other grounds, then it can always put out to tender a contract to operate a similar service in competition with the commercial service;

(ff) Further, because the commercial services are in the same locality (and, sometimes, exactly the same route but at different times) as the contract services (with the maximum fares for that being fixed in the contract) the ability to alter fares on the commercial services is constrained by the fares fixed for the contract services. This inability is further strengthened by the impact of concessionary fare contracts dealt with below;

(gg) As the same buses are used the other aspects of quality of service are similarly constrained. It is, in practical terms, extremely difficult for an operator of both types of services to segregate the buses for the different types of services;

Concessionary Fares Contracts

(hh) In the case of both types of service GW operates a Concessionary Fare Reimbursement policy that is available to operators prepared to enter into a contract with GW in respect of it. Concessionary fares of about 50% of full fare are available for children, senior citizens and beneficiaries. The bus operator can claim from GW part of the difference between that concessionary fare and the full fare if, but only if, the full fare does not exceed an upper limit set by GW;

(ii) At approximately 3% of fare revenue, this represents a valuable income source in the Wellington region;

(jj) The combined effect of the contract services and concessionary fares is that GW controls the prices and level of service in the public transport market. If anything this will increase under the new regime;

School Buses and Bus Charters

(kk) The Staff Report leading to Decision 318 (Stagecoach/Yellow Bus Co.) at paragraph 65, records that there were numerous market participants and few impediments to entry in relation to the provision of school bus and bus charter services in the greater Auckland metropolitan region. Consistent with that the subsequent decision, Decision 326, did not further consider the school bus market – see paragraph 74 of that Decision;

(ll) In Decision 551 (Red Bus/Leopard) the Commission did look at the School Bus Rights Market at paras 273 to 284. It is clear from this that:

- there are several competitors;
- new entry is easy;
- the merger would have no impact;

(mm) That same situation prevails in the greater Wellington region. Buses can be up to 25 years old and can cost as little as $25,000.

Co-ordinated Market Power

23 Identify the various characteristics of the market that, post-acquisition, you consider would either facilitate or impede co-ordination effects

(a) The all pervasive influence of GW makes co-ordinated market power unavailable in relation to users. There is simply no ability to charge more or give less as pricing and quality are not fixed by the market participants;

(b) In relation to tenders, similarly GW is a monopsony;

(c) The tender process is a very public one;

(d) GW has the power to reject tenders, repackage the tenders and to actively seek new entrants (including packaging the tenders in a way that would suit the new entrant);

(e) GW also has the power to negotiate with the lowest tenderer.

24 Identify the various characteristics of the market that, post-acquisition, you consider would facilitate or impede the monitoring and enforcement of co-ordinated behaviours by market participants.

(a) The fares are fixed by GW, are very public and will remain so. The merger will not impact on that;

(b) In relation to the tender market NZBL endorses the views of the Commission as set out at paras 247, 251 and 256 of Decision 551 but says, further, that there would be no way of knowing whether or not an outsider might enter the tender round. It is simply impossible to collude with all possible tenderers.

25 Indicate whether the markets identified in paragraphs 11 and 14 above show any evidence of price co-ordination, price matching or price following by market participants.

(a) The chief competitor in the markets identified is the private motor car;

(b) In relation to the so called "scheduled bus passenger market" the fares are determined by GW so, again, the question does not apply;

(c) In relation to the tender market there are few competitive bids so there is no evidence of price co-ordination, price matching or price following.

26 Please state the reasons why, in your opinion, the transaction will not increase the risk of co-ordinated behaviour in the relevant market(s).

Because of the separate geographical markets and for sound operational reasons, NZBL and Mana do not compete and, in the counterfactual of a new different owner of Mana, this will not change.

PART IV: CONSTRAINTS ON MARKET POWER BY POTENTIAL COMPETITION

Conditions of Entry

27 The following listing gives different types of market conditions that may affect the ability of new firms to enter the market:

- *Frontier entry conditions*
  eg. tariffs, quarantine requirements, international freight costs.

- *Legislative/regulatory conditions*
  eg. entry licensing, Resource Management Act requirements, health and safety standards.

- *Industrial/business conditions*
  eg. access to raw materials, critical inputs, economies of scale, access to technical knowledge requirements, capital requirements (and capital market's perception of the risk and return), sunk costs (ie. irrecoverable or exit costs), influence of branding and sales promotion, technical specifications.

- *Other conditions*
  eg. responses to expansion by major firms.

Which, if any, of the conditions identified above do you consider would be likely to act as a barrier to the entry of new competitors, where they otherwise would have the incentive to do so in response to a sustained effort by the combined entity to raise price, or to lower service or product quality?

The constraints on market power by potential competitors have already been addressed in Part III, Q. 17. NZBL does not consider that the barriers to entry are high. Further, to the extent that there are perceived difficulties on the part of a new entrant, GW has the ability and incentive to set conditions for tender to minimise that. Accordingly, there is little distinction between near and new entry.

28 Please name any businesses (including overseas businesses) which do not currently supply the market but which you consider could supply the relevant market(s) by:

- investing in new production facilities to produce the product;
- overseas companies diverting production to New Zealand;
- domestic companies expanding, or changing the utilisation of, existing capacity to produce the relevant products (where this would involve substantial new investment).

Specify for each named business which of the above three might apply.

NZBL refers to the answer to questions 17 and 18.

29 What conditions of entry do you consider would most influence the business decisions to enter in each case?

Any new entrant is likely to be attracted by a suitably packaged tender round. A particular operator may have the incentive to enter if it has lost out in a tender round where it previously held contracts as that would be one way of putting its buses to use.

Likelihood, Sufficiency and Timeliness of Entry

30 How long would you expect it to take for entry to occur, and for market supply to increase, in respect of each of the potential business entrants named above:

The common denominator in each case is a new tender round.

31 Given the assessed entry conditions, and the costs that these might impose upon an entrant, is it likely that a potential entrant would consider entry profitable at pre-acquisition prices?

Yes, as is illustrated by the changes that have occurred elsewhere. See the answer to Q. 21 above.

32 Would the threat of entry be at a level and spread of sales that it is likely to cause market participants to react in a significant manner?

Yes. This is an ever present reality that NZBL factors into its tenders. This is illustrated by what happens when NZBL is the sole tenderer (which is most of the time). GW then seeks explanations as to its pricing which, in about 75% of the case, satisfies GW. In the other 25% some additional concessions will be negotiated but, because the price was constrained by the threat of new entry, there is not a major move.

33 What conditions of entry do you consider would influence the business decision to enter the market by setting up from scratch ie. *de novo* entry?

Suitable packaging of tenders.

34 How long would you expect it to take for *de novo* entry to occur?

The tender conditions would be adjusted to allow whatever was necessary.

35 In your opinion, to what extent would the possibility of *de novo* entry constrain the merged entity?

This is a very real threat that would always constrain NZBL with the risk that the bigger it is the more vulnerable it is to GW structuring the future tender rounds to favour an outside interest.

PART V: OTHER POTENTIAL CONSTRAINTS

Constraints on Market Power by the Conduct of Suppliers

36 Who would be the suppliers of goods or services to the merged entity in each market identified in questions 11 and/or 14?

The principal supplier is GW as the supplier of the subsidies under the contract services and of the concession fare top up for all types of services. The other principal suppliers of materials are:

- the bus manufacturers;
- the oil companies.

37 Who owns them?

No one connected with the acquirer.

38 In your opinion, to what extent would the conduct of suppliers of goods or services to the merged entity constrain the merged entity in each affected market?

The role of the GW is crucial and its power is considerable – see answer to Q. 22.

Constraints on Market Power by the Conduct of Acquirers

39 Who would be the acquirers of goods or services supplied by the merged entity in each of the markets identified in questions 11 and/or 14?

Individual passengers and GW.

40 (Where appropriate) who owns them?

NA.

41 In your opinion to what extent would the conduct of acquirers of goods or services to the merged entity constrain the merged entity in each affected market? How would this happen?

(a) Given the freedom on choice and the ready availability of alternative services such as the private motor vehicle and taxis as well as train services, the constraint exercised by consumers is considerable;

(b) As discussed earlier, the GW has overall control of access to the market and as such has the power and will to constrain the conduct of the merged entity.

General

NZBL comments that constraints need to be aggregated. That is, even if, contrary to its views, the Commission considers no one constraint is sufficient, the combined constraints may be.

THIS NOTICE is given by **ROSS THOMAS MARTIN,** Executive Chairman of **NEW ZEALAND BUS LIMITED**

The Company hereby confirms that:

- all information specified by the Commission has been supplied;

- all information known to the applicant which is relevant to the consideration of this application/notice has been supplied.

- all information supplied is correct as at the date of this application/notice.

The Company undertakes to advise the Commission immediately of any material change in circumstances relating to the application/notice.

DATED this day of December 2005

SIGNED by **NEW ZEALAND BUS LIMITED**

____
Executive Chairman

The name of the applicant company was affixed hereto in the presence of:

____
Director

____
Director

APPENDIX

MARKET DEFINITION

A1 NZBL does not accept the traditional market analysis that the Commission has used in prior applications. It proposes in this Appendix to set out its reasons for a personal transport services market.

A2 Passengers have a choice between using buses or competing modes such as trains, taxis, shuttles, private vehicles, ferries or walking or cycling. There is much conflicting research of a hypothetical nature of the degree to which bus service customers are "*captive*", with problems of definition and analysis. In Decision 326 the Commission drew on overseas studies as to the cross elasticity of demand between bus patrons and car usage. However, this evidence is not all one way. Mike Copeland in his report of 17 February 1998 supplied in relation to that Application, pointed to a British study that showed longer term elasticity may approach the 0.8 level. But, this elasticity understates the New Zealand position. Britain (and Europe) are characterised by:

- much higher population densities making urban and suburban transport more practical;
- lower car ownership;
- much higher petrol, insurance and garaging costs;
- a more determined campaign to discourage the bringing of cars into the cities.

A3 There is, however, irrefutable New Zealand experience of high cross elasticity drawn from Tauranga where the urban bus service was withdrawn from much of the city in 1986. Subsequently, bus service users made the following adjustment to their travel patterns:

- used private car/motorbike	34%
- travelled to alternative destinations	21%
- used taxis	12%
- walked/cycled	12%
- used other bus services	9%
- used ferry	2%
- combination of modes	9%

(This data is interpolated from C Perrins "The Withdrawal of Urban Bus Services in Tauranga" ATRF 1988.) This experience suggested strongly that bus service users do have alternatives and are not "*captive*" in any real sense. This is supported by the material from Canterbury Regional Council acquired by the Commission in respect of the clearance application leading to Decision 318.

A4 This information is backed up by responses to the annual customer satisfaction survey carried out amongst public transport users by the Auckland Regional Council.

A5 In the 2003 survey (the last when this question was asked), passengers were asked "*If no public transport at all had been available (ie, no buses, trains or ferries) what is the* <u>*most*</u> *likely way that you would have made this trip?*"

Responses were:

	Total	Peak	Non-Peak
- car/motorbike (as passenger)	33.6%	32.6%	33.8%
- car/motorbike (as driver)	25.6%	26.7%	25.3%
- taxi	10.2%	7.0%	11.0%
- cycle	3.6%	4.7%	3.3%
- walk/hitch hike	13.8%	15.1%	13.5%
- would not have made journey	11.1%	12.8%	10.7%
- other	1.8%	1.2%	1.9%
	99.6%	100%	99.5%

These figures mirror the Tauranga figures and illustrate that those figures are not dependent on the geography of that city.

A6 It is, of course, unnecessary for all customers to be able to shift to an alternative provided there are significant numbers with that option and the option has important effects on the supplier. That was the basis of the Commission's clearance in the Kiwi/Tui Dairy Merger Decision of August 1996 – note paras 52, 65.

A7 This demand side constraint is evidenced by the fluctuation in patronage. There was a steady decline in patronage of bus services throughout New Zealand since 1947 – typically 1-2% per annum until the early 1990s. Subsequently, the bus operators in the main centres (and their respective regional councils), realising that increased fares and inadequate service were driving their customers away, improved standards and froze fares and have been successful in attracting back significant patronage. However, in Auckland the trend has started to reverse with patronage peaking in mid-2003 and now declining. Some, but not all, of that can be explained by the decline in the number of Asian students. Those trends in patronage are only explainable on the basis that passengers do have alternatives should NZBL attempt to exercise market power.

A8 Within the Wellington market the old Wellington City Transport suffered a 30% decline in fare revenue in the late 1980s and early 1990s as passengers exercised their ability to move away from buses to other means of transport. Although that recovered in the later 1990s, even then and despite an increase in services, the growth in fare revenue was well behind. This is because of the countervailing power of passengers and the options available to them. In the 12 months to 30 June 1990 (the then year end) fare revenue was $14.298m. In the 12 months to 30 April 1999 (the year immediately prior to the first fare increase in 10 years) fare revenue was [ ] (ie. less than a [ ] rise in nominal fare revenue over almost 9 years). In the meantime inflation rose by about 17%.

A9 In January 2000 the negotiations in relation to the subsidy for operating the trolley system were finally concluded after 18 months of negotiations with the GW. GW insisted on lowering the subsidy. It moved from [ ] per annum down to [ ] per annum (a decline of over 20%). However, as the quid pro quo, GW suggested a fare increase and advised that it would consent to such increase. Because of the rise in operating costs (especially diesel and also wages) NZBL was forced to agree. Considerable effort was made to explain this to customers to maintain their support, including an extensive advertising campaign with, for instance, full page advertisements in the daily papers – see, for instance, the attached three quarter page advertisement from The Dominion of 19 February 2000 (reduced to A4).

A10 Those fares have now been held for approaching 6 years. However, the trolley bus contract has again come up for renewal and the negotiations for that have, again, taken considerable time.

A11 In the earlier 2000 negotiations GW contended that the trolley bus fleet had been sold to NZBL for nil price and, accordingly, NZBL should not be allowed any allowance for cost of capital (compare that with the detailed arguments over the cost of capital to a price controlled entity like Natural Gas Corp. and line companies). However, all of these buses now have to be replaced. NZBL has sought provision for the cost of capital in relation to these replacements. GW has refused to increase the subsidy and, instead, has again suggested a fare increase.

A12 In the meantime, there has been an increase in patronage as customers have reacted to improvements in the service (eg. newer buses, some increase in frequency etc.).

A13 This highlights both the constraint of demand side substitution and the power of GW. If NZBL had market power it would have been seeking to increase fares more frequently and by greater amounts. Once a decision is made to operate a scheduled service the costs become largely fixed – ie. the wages, fuel and operating costs are basically fixed whether the bus is full or empty. Accordingly, marginal losses of patronage arising from customer dissatisfaction with the price or quality of the service has a significant impact on the viability of the service.

A14 It is important to note that the loss of even a small percentage of bus passengers has a major effect on bottom line profitability.

A15 Notably, bus patronage in Wellington is significantly higher than in Auckland – c20 –25% of morning commuter traffic in Wellington compared with c10% in Auckland. Because Wellington is not notably economically poorer off and has a similar, if not higher, per capita car ownership, this indicates a much higher level of persons in Wellington opt to use the bus rather than alternatives <u>that are already available to them</u>. If, then, NZBL attempts to raise prices above cost of supply or reduce services it is vulnerable to a significant loss of patronage.

Bus company acquisition – an economic assessment

22/12/05

1 Summary

New Zealand Bus Ltd (NZBL) is proposing to buy Mana Coach Services Ltd (Mana). We understand that the main motivation is to exploit Mana's better management and operating systems in NZBL's Stagecoach operations in Auckland and Wellington.

For the Commerce Commission, the key competitive question will be whether the proposed acquisition will substantially lessen competition in the relevant geographic markets in which the Greater Wellington Regional Council (GW) procures bus services.

In our view, barriers to a bus company's competing for contracts in an area outside its existing operations are low. Accordingly, the proposed acquisition will not substantially lessen competition. There are many other potential providers available to GW if the merged entity were to attempt to raise "prices" (subsidy bids).

Notwithstanding the low barriers, Wellington Stagecoach and Mana have not competed in each other's areas in the past. As we understand it, this is because GW has preferred to deal with one company in each market area. GW has operated in this way, confident that its countervailing power has prevented any excess profit taking by providers. GW's countervailing power derives mainly from its ability to negotiate services and subsidies directly with a single bidder, under threat of cultivating additional bidders and re-tendering.

The Commission has previously taken the view that there are substantial barriers to competing for contracts in an area outside a bus company's existing operations. In our view, if GW were seeking to promote competition, then there would be no significant barriers. From an economic point of view, the much discussed fear of retaliation is not a credible barrier. To our knowledge, it has never happened.[1]

However, if competition is in fact being limited by firms' fear of retaliation or by other barriers to a bus company's competing for contracts in an area outside its existing operations, then the proposed acquisition would still not substantially lessen competition. In this case, the reason would be that the markets in which Wellington Stagecoach operates are "outside" Mana's operating areas and *vice versa*. In other words, if there are barriers to competition, then we must infer that Mana and Wellington Stagecoach have not actually been providing a competitive constraint on each other's tender bids. But it would also follow that the two firms would not be competing effectively in the counterfactual (where Mana is bought by another bus operator from elsewhere, not NZBL).

[1] Maybe once arguably in Hamilton and Tauranga.

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The rest of the paper is organised as follows. First, we summarise our understanding of the motivation for the acquisition; there are sound alternatives to the proposition that NZBL is buying out its major potential competitor. Next, we note that the counterfactual to the proposed acquisition is most likely a sale to another major Australasian bus operator. We then define the relevant product markets but skip the supply side market. We do so because with *actual* monopolist operators in Wellington Central/Hutt Valley and North Wellington/Porirua/Kapiti, the question as to the geographical supply market is the same as the central competitive question identified above. The two main sections of the paper assess GW's countervailing power and the possible barriers to competing outside the area of one's existing operations.

2 Reason for the Acquisition

We understand that Mana is attractive to NZBL for two main reasons.

The first is that NZBL sees Mana as having superior operating systems and know how in tendering, contracting and scheduling. We understand that Mana's operating margin is substantially better than that of NZBL. NZBL sees an opportunity to learn from Mana's owners and create significant additional value in its Stagecoach operations.

Secondly, Mana is regarded by NZBL as an attractive investment proposition. One might think that NZBL will simply have to pay what Mana is worth, but there are two ways in which NZBL may well get a bargain. First, NZBL has pre-emptive rights and Mana may thus not be able to expect to capture the full market value of its business. This is because other bidders will not want to put in all the effort of fully assessing the company just to help Mana get a slightly higher price from NZBL.[2] Secondly, additional value may be available to NZBL through extending its bulk purchasing advantage in fuel and tyres to the Mana operations.

3 The Counterfactual

If NZBL does not buy Mana, we assume that Mana would sell to another of the existing major operators in New Zealand like Ritchies or Tranzit or to an overseas firm like Connex. A number of other possible players are identified in paragraph 16.5 of the Application.

Where we refer to Mana in the remainder of this paper, we will generally mean Mana under this new ownership unless we are referring to the history of the firm's operations.

4 Market Definition

4.1 Product Dimensions

GW and their passengers

Our focus in this report is on tendered bus services. For this reason, we do not enter the debate over the degree of substitutability between bus services and other modes of transport. In our view, it seems most constructive to think of there being a market in which GW provides subsidised bus passenger services to the community. As is well known, GW determines fares and services. We suspect that GW and other regional

[2] One indication that NZBL may be getting a good deal is that the agreed price is 5.5 times the forecast 2006 EBITDA, less that the 6.4 multiple paid by Infratil for Stagecoach.

councils are tightly constrained in respect of the combination of the fares they can charge and the service levels they must provide if they are to maintain patronage.[3]

The important point is that having identified the optimal level of fares and services from a social and economic point of view, GW chooses not to provide its own buses but out-sources instead.

GW and bus companies are in a bus contract market

Separating GW's taking ultimate responsibility for bus passenger services, we see the relevant market for this acquisition as a wholesale-type activity in which GW 'procures' bus services. We will refer to this as the contract bus market.

In this market, bus companies like NZBL are paid to provide buses and drivers. Economically, it does not matter that the bus companies collect the fares **and** get paid by GW. That is just a consequence of the GW decision to provide bus passenger services to the community at less than cost.

From GW's point of view, the enterprise is socially profitable but loss making in cash terms. GW minimises the net dollar cost by offering exclusive licences and holding tenders. With specified fares and services, potential providers compete in only one dimension, the required subsidy.[4]

GW also procures distinct services for school children, partly to keep them away from adult passengers and partly because the services can be provided more cheaply in older buses. In our discussion, we will not need to distinguish between GW's two clienteles.

Commercial bus services

We understand that about 20% of bus services in the Wellington area and 25% in the Hutt Valley are unsubsidised commercial services. For this separate market, the relevant parties are the bus companies and the passengers. GW has no role except as a licensing authority. Fares appear to be effectively set by those on the subsidised routes because passengers will not tolerate a difference.[5] As a result, the provider is seeking out unsubsidised routes where a service can be attractive enough to users to be viable. Providers must register the route with GW.

GW has the right to decline a registration if it will cannibalise existing subsidised routes. When subsidised routes are re-tendered, providers can make a tender bid or offer to run a commercial service (with no subsidy). After a tender winner has been announced, a losing bidder is allowed to register commercial services over the group of routes. The mechanism is helpful for GW as it can get the service without any subsidy payment.

We do not comment further on the competitive effects of the proposed acquisition on the provision of commercial services. There appear to be no instances of head to head competition in commercial services; once one firm has registered a route, it is very unlikely that another can be viable. But with prices effectively capped, we see no potential efficiency problem either. We see no reason why the original provider would

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3 Whether or not just the bus services constitute a market in themselves depends on whether GW could raise fares by 5% (or reduce service standards in some equivalent fashion) without losing money overall.

4 Note that 60% of Wellington Central bus operations are trolley buses. NZBL is the only owner of trolley buses in New Zealand. These services are outside the tender process; GW simply negotiates with NZBL for trolley bus services. While it continues to suit GW, this is a non-contested service.

5 Commercial and subsidised services are often "interworked". For example, there may be an hourly commercial service with subsidised buses on the half hours, increasing the service level.

not supply every profitable route and make every effort to maximise patronage efficiently across all services.

4.2 The Geographic Dimension

The demand side

GW is procuring subsidised bus services for passengers in five distinct geographic areas: Wellington Central, Hutt Valley, North Wellington,[6] Porirua and Kapiti.[7] There is very little bus travel between the areas, not least because of GW support for "intercity" trains and restriction of licenses for competing bus services.[8] Passengers wanting to travel around by bus in each area do not regard trips in another area as substitutes but GW's task is similar in each area. For this reason, it is sensible to aggregate the regions as far as GW's demand is concerned.

The supply side—the central issue

In this case, the choice of the geographic market on the supply side is inseparable from the analysis of the competitive effects of the proposed acquisition. In a standard Commerce Commission market analysis, a ssnip test considers whether a *hypothetical* monopoly supplier in one region is prevented from charging more than 5 percent above competitive levels by suppliers in other regions. Since we have *actual* monopoly suppliers in Wellington Central and the Hutt Valley and in North Wellington, Porirua and Kapiti, we will leave this analysis to section 5.

4.3 Conclusions on Market Definition

The product dimensions seem uncontroversial:

- GW procures bus services in a contract bus market in order to provide transport services for regular passengers and for school children
- Bus companies offer unsubsidised commercial services where they can.

Geographically, GW procures bus services in five distinct areas. Whether the effective substitute suppliers of bus services are just those currently operating in the GW region or include those operating elsewhere is the main issue in this report. Accordingly, we leave this aspect of the market definition open.

5 Competitive Analysis

The key competitive question is whether the acquisition will substantially lessen competition in the contract bus market. In other words, would the bringing together of Wellington Stagecoach and Mana enable the merged entity to raise its subsidy bids to GW for bus contracts in the five geographic areas. The point of comparison—the counterfactual—is the bidding by Wellington Stagecoach and an independent Mana (under new ownership).

In our view, the acquisition will not reduce the competitive pressures available to GW in securing efficient subsidy bids. We see providing bus services as a simple industry with low barriers to entry. GW has access to many potential providers.

6 Newlands, Johnsonville, Paparangi, Churton Park and Tawa

7 GW also procures services for the Wairarapa but not from NZBL or Mana.

8 There are some exceptions: the rights to operate buses to and from Eastbourne buses have been grandfathered rather then forcing commuters to transfer to the train; some buses have been allowed to and from Johnsonville at peak times when the rail carriages were at capacity; some buses from Tawa allowed when Tawa ceased to be an express train stop.

Nevertheless, there has only been very limited actual competition for tenders in the Wellington, Porirua or Kapiti regions. Madge Motors has won a tender for a service in Kapiti and there has been some competition for school bus services in Wainuiomata and Eastbourne but Mana and Wellington Stagecoach have not competed for tenders in each other's areas.

As we understand it, the reason is that GW prefers to negotiate with one provider in each geographic market and has not to date seen the need to actively cultivate rival bids. However, as sole buyer in each region, GW has significant countervailing power. We discuss this in the next section before explaining why we think barriers to entry are low.

We conclude our analysis by allowing for the possibility that we are wrong about barriers to entry and that the Commission's previous analysis better reflects how industry players perceive their opportunities. As mentioned earlier, if there are significant barriers, then it follows that the two firms will not compete effectively in the counterfactual and the proposed acquisition will not substantially lessen competition.

5.1 Countervailing Power

GW appears to have preferred to deal with the incumbent in each geographic market confident that its negotiating strength has enabled it to fine tune services while securing the lowest possible bids. Ultimately, GW's countervailing power derives from its ability to cultivate additional bidders and re-tender. If GW were to actively seek additional tenderers, there would be many potential providers—even without Mana—so GW's countervailing power would continue to be a complete constraint after the proposed acquisition. We understand from discussions with NZBL that GW could most easily attract new entrants by holding tenders for multiple small contracts, allowing bidders to select efficient subsets.

Regional councils could even "invest" in additional competition. The Competitive Pricing Procedures (CPPs) under which regional councils operate, appear to limit a regional council's ability to pay more just to engage an additional provider. In reality, "quality" considerations leave councils with considerable discretion.

We understand that both the Ministry of Transport and Land Transport New Zealand are currently conducting reviews of bus service procurement processes and that the Auckland Regional Transport Authority is seeking additional powers for its dealings with providers. The reviews might also lead to the removal of less competitive features of current CPPs such as those that require councils to publish the key bids after a tender. As the Commission has pointed out,[9] when there are just two bidders, these rules increase the scope for coordinated market power.

If regional councils came to the view that network efficiencies (economies of scope) were limiting the ability of other providers to tender, they may need to tender much larger groups of routes to enable a more efficient provider to take over with a lower subsidy requirement. This may require a transitional mechanism such as that used in the State of Victoria to guarantee continuity of service.[10] We understand the ARTA is considering buying some buses and leasing them out to ease the transition between providers.

[9] Decision 551 at para 223

[10] In Melbourne, the Public Transport Division of the Department of Infrastructure lets the franchise contracts for trams and trains on condition that the Department retains an option to purchase the rolling stock involved at the end of the contract. The Department has no long term ownership of the rolling stock, just a mechanism to ensure an efficient transition should a new provider win the tender.

In Decision 551, the Commerce Commission took the view that Environment Canterbury had not fully exploited its countervailing power and would continue to fail to do so. In our view, this is unrealistic. It is not logical to regard public sector agencies that buy services as insensitive to cost increases while at the same time regarding the cost increases as socially damaging.

We would expect regional councils to respond vigorously if they perceived any adverse shift in the tender bids. We understand that council transport officials are under increased pressure to account for contract spending. For GW, public transport (trains and buses) accounts for 40 percent of spending.

In summary, we believe that one plausible explanation for the history of largely uncontested tenders is that there are no barriers to competition but GW has preferred to operate in this way and has not felt the need to cultivate additional bids. GW will have taken this approach satisfied that its negotiations have ensured that its costs have not been unduly raised by dealing with just one provider in each sub-region.

If GW does indeed have this countervailing power, then its ability to cultivate competition in Wellington—should the need arise—is not dependent on Mana. GW could attract another provider from anywhere. In these circumstances, the proposed acquisition will not substantially lessen competition.

If we cannot assume that GW will exercise its countervailing power but there are no barriers to competition, then we cannot explain the lack of competing bids to date but do not have to worry about the proposed acquisition. If there are no barriers to competition, there can be no substantial lessening of competition.

The alternative inference from the history is that there has been no competition in the Greater Wellington region because there are significant barriers to a bus company's competing for contracts in an area outside its existing operations. We discuss this possibility next.

5.2 Barriers to Entry

In past decisions, the Commission has concluded that although individual conditions of entry into an area outside one's existing operations are not too problematic, the cumulative effect of a number of incumbent advantages and entrant sunk costs is that there is a significant barrier to entry from outside a region.[11]

In our view, the analysis is unconvincing. After the privatisation of bus services in the UK, an experiment was undertaken in Oxford allowing open competition. It became obvious that practically anyone could buy a bus, sort out viable routes and compete for passengers. The region moved to the exclusive franchises that are now common, in order to extend services and because of the unruly behaviour of competing drivers, for example racing to be first to crowded bus stops. If there are barriers, they must be introduced by the franchising process.

In the next few paragraphs we discuss each of the suggested barriers in turn.

The cost of a depot

A company setting up operations in Wellington or the Hutt Valley would need a depot. But this is simply an industry cost, not a barrier to entry. The potentially high value of such land is just as much a cost to an incumbent as to an entrant. This is because the incumbent's shareholders will be expecting a return on the market value of the land they

[11] A summary is given in Decision 551 at paragraph 172.

are using for a depot. We understand that Infratil is already thinking of finding alternatives to the Kilbirnie bus depot site because of its high value in alternative uses. Land in the rail yards is one possibility.

Patronage information

New tenderers need patronage figures. They can collect this information themselves but the procurer can lower the potential entrant's costs by providing the data. Information collected during the term of current contracts may be protected by those contracts and thus not available for the next round of tenders. But the next round of tenders could be let on the understanding that patronage data will still be required from the bus provider and will be made available to all tenderers in subsequent rounds.[12]

In any event, the information is not costly to collect or process. In another report accompanying the Application, D. Overington Consulting advises that for an established bus operator in another region, the irretrievable costs of mounting a challenge for contracts in another region would be about $110,000 for a 100 bus operation that might earn $10 to $12 million pa over a three to five year contract. The $110,000 sunk cost is a very small fraction of the value of the contract over its life.

In the same report, Mr Overington estimates that re-tendering costs the incumbent $50,000, so the cost disadvantage to the outside bidder (just $60,000) is also negligible.

Standards

It is sometimes suggested that high standards required of bus providers pose a barrier to competition. Incumbents upgrade their fleet progressively but entrants are thought to be unwilling to acquire complying buses just on the off-chance of winning a tender. Changes in standards may be costly to accommodate but these matters are all negotiable with the relevant regional council.

If councils find that competition is being restricted by the standards they are setting on buses, it is within their power to lower the standards or allow the entrant to comply more slowly.

An example is provided by the Wellington trolley buses. The council prefers electric vehicles for their lower local environmental impact, but not at any cost.

Network efficiencies

It is likely that there are network efficiencies, that is, economies of scope, in bus operations over a region. However, these are not a barrier to competition provided those tendering have the opportunity to assemble groups of routes that realise reasonable efficiencies. We understand that regional councils often tender several routes individually but with the option of bidding on them all together. With routes being tendered about twice per year, there are regular opportunities to refine one's combination of services.

NZBL believes that GW's packaging of route tenders leaves NZBL open to competing bids on equal terms from outside providers.

Sunk costs

In addition to mounting a bid, an entrant needs to secure a depot and buses. There is typically a four month lead time between the announcement of winners in a tender round and first providing the service.

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[12] If information seemed still to be a problem for the next round of tenders (before the information protection was removed), "gross" contracts could be used for one round. In such contracts, GW would take the risk on patronage. It appears that gross contracts are becoming more common in Auckland and Hamilton. Penalties and bonuses are used to maintain the incentives for the operators to maintain patronage.

A combination of leased buses from businesses like Associated Bus Services and new buses from Designline should allow an orderly start-up over this time. We understand that 90% debt funding is readily achievable subject to the contract. Again, if the council needs to facilitate more competition, lead times are negotiable and can be allowed for in the CPP.

For the depot, it should be adequate to secure an option over the required land during the run up to the tender process and take up the option if successful.

Neither process involves significant sunk costs should the bid fail.

Incumbent response

In competition analysis, retaliation is usually only thought of as a barrier to entry if the entrant has to incur significant sunk costs. We don't believe there are significant sunk costs involved in competing in a tender. Furthermore, once the entrant has won a contract, they are immune from attack for the term of the contract. When that contract comes up for tender again, there is a possibility of losing to the original provider but that would have been allowed for in the entrant's bid.

The incumbent response that is discussed in the industry is for example, the proposition that if Mana tendered for routes in Wellington, Stagecoach would tender for routes in Mana. Superficially, the idea is plausible but it is not clear that it would be a rational response once entry had actually happened.

If an incumbent loses a block of services (call them A) in a tender, it will have buses to spare. The incumbent would probably not want to lease the buses to the entrant (as this might invite further competition) but could absorb the surplus buses into its replacement program (i.e. saving new purchases), sell the buses to another operator that needed replacements or sell the buses to a lease company like Associated Bus Services. It is not clear that there would be a serious loss involved.

With or without the surplus buses, the company "attacked" may want to signal its displeasure by bidding aggressively against the entrant in the entrant's home territory to take a block of services, B. This would only be rational if there were a good prospect of recovering the initial equilibrium and the profits that that equilibrium presumably entailed. So three to five years later, the entrant would need to abstain from bidding on the A services, trusting that the original incumbent would subsequently not bid again on B and the previous state would be restored.

In game theory, practically any outcome is possible with enough competitive interactions and enough repetitions of the tender process. But with a regional council as single buyer acting to limit profits and maintain competition, the hypothesised behaviour should not be regarded as a credible general barrier to competition.

In addition, the mechanism cannot deter coach operators or others like Connex that do not have urban bus operations.

Empirically, we are aware of only one example of retaliation ever having happened. Hamilton City Bus Company won some school bus tenders in Te Puke near Tauranga. Bayline, the Tauranga based bus company responded, bid for and won some urban bus contracts in Hamilton. The Hamilton company was bought out and became Go Bus and Go Bus bought the Bayline bus operations in Hamilton. Go Bus still has the Te Puke contracts. So Bayline did retaliate but did not succeed in restoring the original market.

5.3 Commentary

We have explained why we believe that barriers are low and that the reason for competition for contracts being uncommon is that GW has not seen the need to cultivate additional bids. With low barriers to entry and GW well positioned to facilitate the process, the proposed acquisition cannot substantially lessen competition. Mana is not crucial to GW's ability to contain Stagecoach. Similarly, Wellington Stagecoach is not crucial to GW's ability to contain Mana.

In the alternative…

In a number of decisions, the Commission has repeatedly come to the view that there are significant barriers to a bus company's competing in areas outside its existing operating area. If this view is in fact correct, then this would indeed explain why Stagecoach and Mana have not competed for contracts in each other areas. But the existence of significant barriers would also imply that the proposed acquisition will not substantially lessen competition because there would be no competition in the counterfactual.

If sunk costs, information advantages, retaliation and network effects are barriers to entry, then they will prevent Stagecoach and Mana from competing in each other's areas just as much as they prevent operators from further afield from bidding in Wellington or in Mana's areas.