

Statement of Preliminary Issues

Kinetic NZ Holdings Limited / NZB Holdco Limited

13 May 2022

Introduction

1. On 14 April 2022, the Commerce Commission registered an application (the Application) from Kinetic NZ Holdings Limited (Kinetic) seeking clearance to acquire 100% of the issued share capital of NZB Holdco Limited (NZ Bus) and its subsidiaries (the Proposed Acquisition).¹
2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.²
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by 27 May 2022.
5. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The parties

6. Kinetic operates bus and coach services throughout New Zealand and Australia, including urban bus and school bus services throughout New Zealand through Go Bus Transport Limited (Go Bus). Go Bus has a fleet of over 1,700 vehicles, approximately 2,500 staff and operates 29 depots between Auckland and Invercargill.
7. Kinetic also offers airport transfer services at Auckland Airport through SkyBus NZ Limited (SkyBus).

¹ A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

² The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

8. NZ Bus provides bus and coach services in Auckland, Wellington and Tauranga. It is majority owned by investment funds managed by Next Capital Pty Limited (Next Capital), an Australian private equity firm.
9. NZ bus operates urban bus services in Auckland, Tauranga, and Wellington with a fleet of over 800 buses, approximately 1,300 drivers, and 14 depots.

Our framework

10. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.³ As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
11. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).⁴ This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
12. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
 - 12.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
 - 12.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 12.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

Industry background

13. The customers for urban bus services in New Zealand are regional authorities such as Auckland Transport, Greater Wellington Regional Council, Bay of Plenty Regional Council, and so on.
14. The principal customer for school bus services is the Ministry of Education (MoE).⁵

³ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz.

⁴ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁵ Some regional authorities also procure some school bus services, eg Bay of Plenty Regional Council.

15. Regional councils procure urban bus services via competitive tender processes, the structure of which is governed by a framework called the Public Transport Operating Model (PTOM), which was introduced in 2013. Kinetic says that under the PTOM, regional councils use Regional Public Transport Plans to define public transport services and allocate them into “units” of at least one full route, and possibly multiple routes.⁶ These units are then put out for competitive tender.
16. In the case of urban bus services, the successful operator receives an exclusive contract to operate services on the specified routes, usually for a period of nine years.⁷ Kinetic says it is possible that individual factors could influence a different term of the contract, including any arrangements for the operator to fund more costly electric vehicles, so as to allow sufficient time to recover the cost of those vehicles (vs the cost of diesel buses).⁸
17. The MoE conducted a two tender procurement approach for school bus services between July 2020 and May 2021. Tender 1 made approximately 10% of individual routes available for award and allowed smaller regional suppliers to compete for routes appropriate to their capacity. Tender 2 was designed for larger transport providers and offered all remaining routes in groups. These new bus contracts began from Term 1, 2022,⁹ and are for an initial term of six years with two three-year rights of renewal.¹⁰
18. In January 2021 the Government announced its commitment to decarbonising the public transport fleet. By 2025, the Government will only allow zero-emission public transport buses to be purchased, with a goal of complete decarbonisation of the public transport bus fleet by 2035.¹¹

Market definition

19. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.¹²

Past court decisions

20. In 2006 the Commission brought proceedings in the High Court to restrain NZ Bus from completing the acquisition of the 74 per cent of Mana Coach Services Limited (Mana) that it did not already own.¹³

⁶ The Application at [37].

⁷ The Application at [40].

⁸ Ibid.

⁹ <https://www.education.govt.nz/school/property-and-transport/suppliers/school-bus-procurement/>.

¹⁰ The Application at [47]-[51].

¹¹ <https://www.transport.govt.nz/area-of-interest/environment-and-climate-change/public-transport-decarbonisation/>.

¹² Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

¹³ *Commerce Commission v New Zealand Bus Limited* (2006) 8 NZBLC 101 774; (2006) 11 TCLR 679.

21. The High Court considered that the relevant product dimension of the market was for the rights to provide subsidised bus services¹⁴ and that the relevant geographic dimension was the Wellington region as a single market.¹⁵

Past Commission decisions

22. The Commission has considered competition in this industry on a number of occasions in the past.¹⁶ In considering those previous acquisitions, the Commission considered that it was appropriate to define separate relevant markets for each of school, commercial/charter and scheduled urban bus services, and that these markets were likely to be local or regional in geographic scope.

The Application

23. Kinetic submitted that all of the previous Commission decisions pre-dated the introduction of the PTOM in 2013. However, it submitted that some aspects of those decisions remain relevant to market definition;¹⁷ in particular:
- 23.1 Kinetic agrees with the distinction drawn in those previous decisions between subsidised bus passenger services and commercial bus passenger services.¹⁸
- 23.2 Kinetic agrees with the conclusion reached in Decision 551 that school bus services are a separate product market.¹⁹
- 23.3 Kinetic agrees with the approach taken in the previous decisions in excluding alternative modes of transport to buses from the relevant markets, on the basis that the public are only likely to switch between those alternative modes of transport to a limited extent.²⁰
24. Kinetic therefore submitted that there are separate product markets for scheduled urban bus passenger services provided to the general public (urban bus services) and scheduled school bus services (school bus services).²¹
25. We will consider whether the requirements for urban and school bus services are sufficiently different that they should be considered separately, including taking into account whether different companies compete for these contracts.

¹⁴ Ibid at [124].

¹⁵ Ibid at [127].

¹⁶ See Decision 318: *New Zealand Bus Limited and Transportation Auckland Corporation Limited* (24 February 1998) at [60]; Decision 326: *New Zealand Bus Limited and Transportation Auckland Corporation Limited* (15 May 1998) at [130]; and Decision 467: *Red Bus Limited and Leopard Coachlines Limited* (30 July 2002) at [117].

¹⁷ The Application at [28].

¹⁸ The Application at [29] – [32].

¹⁹ The Application at [33].

²⁰ The Application at [34].

²¹ The Application at [23].

26. Kinetic did not explicitly submit on the geographic scope of the relevant product markets, except to note that the only geographic overlap between the parties for the provision of urban bus passenger services is in the Auckland region.
27. We will consider whether the relevant markets are likely to be national or more local.

Without the acquisition

28. Kinetic submits that the relevant counterfactual against which to assess the competition effects from the Proposed Acquisition is the status quo under which Go Bus and NZ Bus would remain in competition with each other.²²
29. We will consider what the parties would do if the Proposed Acquisition did not go ahead. We will consider whether the without-the-acquisition scenario is best characterised as the status quo, or whether the parties would seek alternative options, for example, finding a different buyer for NZ Bus.

Preliminary issues

30. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether unilateral effects or coordinated effects might result from the Proposed Acquisition.
31. In particular, we will investigate whether the loss of competition between the parties would enable the merged entity to profitably raise prices or reduce quality or innovation by itself.²³

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

32. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.
33. The parties overlap in the supply of urban bus services and, without the Proposed Acquisition, may compete in future tenders for urban and school bus services.
34. Kinetic submits that, because the procurement of bus services occurs via periodic tenders, a static view of the market (ie an assessment of the current suppliers of bus services to customers, and the current market shares of each of those suppliers), does not assist in determining whether the market is competitive. Instead, Kinetic

²² The Application at [55].

²³ For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, ie it could increase quality-adjusted prices.

says that the relevant question is whether there will be robust competition at the point of the next tender round.²⁴

35. Kinetic submitted that the Proposed Acquisition would not be likely to substantially lessen competition for contracts to provide urban bus services due to unilateral effects because:²⁵
- 35.1 the procurement process operated by regional councils for both urban bus services and school bus services is robust and designed to ensure a competitive tendering process;
 - 35.2 the top-down approach to determining bus service contracts and the tendering process means that councils exercise competitive discipline in the tendering process;
 - 35.3 the market is dynamic, with many contracts due to expire soon, creating an opportunity for other service providers to successfully compete in the tender process; and
 - 35.4 there are several competitors in the market for both urban bus services and school bus services.
36. Kinetic says there is no overlap in the school bus services market, other than through NZ Bus being a potential competitor in this market.²⁶
37. Kinetic recognises that the High Court²⁷ has previously identified various “barriers to entry” as being relevant in these markets, including:²⁸
- 37.1 insufficient lead times, and contract size and duration;
 - 37.2 lack of access to patronage information;
 - 37.3 commercial registrations;
 - 37.4 lack of local knowledge;
 - 37.5 difficulties associated with the acquisition of drivers and fleet;
 - 37.6 significant tendering costs; and
 - 37.7 difficulty in establishing and finding an adequate location for depots.

²⁴ The Application at [60]-[61].

²⁵ The Application at [57].

²⁶ The Application at [47].

²⁷ *Commerce Commission v New Zealand Bus Limited* (2006) 8 NZBLC 101 774; (2006) 11 TCLR 679.

²⁸ The Application at [89].

38. However, Kinetic submits that since 2013, when the PTOM model was established, these issues have largely been addressed, because the PTOM expressly facilitates councils designing their processes to encourage new entrant participation.²⁹
39. Kinetic also says that while access to depots is key to operating a bus service, the availability of new depots has not proved to be a barrier to competitive participation. It also notes that there is a precedent for local councils facilitating potential access to existing depots.³⁰
40. We will consider, in relation to both urban and school bus services:
- 40.1 closeness of competition: the degree of constraint that Kinetic and NZ Bus impose upon one another. To the extent that any constraint is material, we will assess whether the lost competition between the merging parties could be replaced by rival competitors;
 - 40.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;
 - 40.3 entry and expansion: how easily rivals could enter and/or expand, including their ability to access suitable infrastructure (for example how easily a competitor would be able to access land for building bus depots);
 - 40.4 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity; and
 - 40.5 the impact of future industry trends: whether changes within the industry – in particular the Government’s commitment to fleet decarbonisation – might benefit some industry participants over others, or increase or reduce the barriers to entry or expansion for some or all actual or potential competitors, for example associated with access to charging infrastructure requirements.

Coordinated effects: would the Proposed Acquisition make coordination more likely?

41. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.³¹
42. Kinetic submits that the Proposed Acquisition would not give rise to any concerns regarding coordinated effects. Kinetic submitted that:³²

²⁹ The Application at [90].

³⁰ The Application at [94].

³¹ *Mergers and Acquisitions Guidelines* above n 3 at [3.84].

³² The Application at [96].

- 42.1 closed tender processes run by councils and MoE mean there is no visibility of rival pricing for any particular tender; and
 - 42.2 the markets are highly differentiated in that any tender opportunity invariably involves a unique combination of routes and particular service requirements.
43. We will test these submissions. We will also test:
- 43.1 whether the relevant markets are susceptible to coordination, in particular in relation to price or customer; and/or
 - 43.2 whether the Proposed Acquisition is likely to significantly increase the ability of the remaining competitors post-acquisition to coordinate their behaviour in this way.

Next steps in our investigation

44. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by 15 June 2022. However, this date may change as our investigation progresses.³³ In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
45. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

46. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Kinetic/NZ Bus" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on 27 May 2022.
47. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
48. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

³³ The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.