

11.04/28587

21 December 2017

Russell McVeagh
PO Box 8
Auckland 1140

Attention: Troy Pilkington / Hannah Loke

Dear Troy and Hannah

Letter of unresolved issues – Trade Me Limited / Limelight Software Limited

1. We refer to the application (the Application) dated 11 July 2017 from Trade Me Limited (Trade Me) seeking clearance to acquire up to 100% of the shares in Limelight Software Limited, trading as Motorcentral (Motorcentral) (the merger).
2. The purpose of this letter is to outline the competition concerns the Commission continues to have in respect of the merger and to give Trade Me an opportunity to comment. Responses to the unresolved issues outlined below will assist the Commission with its investigation and in reaching a final decision on the Application.
3. On the basis of information gathered to date, the Commission is currently not satisfied that the merger will not have, or would not be likely to have, the effect of substantially lessening competition. We continue to have concerns that the merger would likely give rise to competition issues in the provision of Dealer Management System (DMS) products to independent dealers. We also remain concerned that the merger would likely give rise to competition issues in the supply of online motor vehicle classified advertising to dealers.
4. The Commission has not yet made final decisions on any issue or on the Application. The views expressed in this letter are preliminary only and could change as the investigation proceeds and more information is provided.

5. The Commission welcomes submissions and any further evidence that Trade Me may provide to address the Commission's concerns.

Process and timing

6. We intend to publish this letter on our website.
7. The Commission is currently due to make a decision on the Application by **28 February 2018**.
8. We would like to receive submissions from Trade Me on the issues raised below. Please indicate by close of business on 12 January 2018 the date on which you intend to provide your submission.
9. Commission staff are available to meet with Trade Me to discuss the matters raised in this letter.

Relevant markets

10. We remain of the preliminary view that the relevant markets likely to be impacted by the merger are:
 - 10.1 the national market for the supply of DMS products to independent dealers; and
 - 10.2 the national market for the supply of online motor vehicle classified advertising to dealers.¹

DMS market

Market definition

11. Trade Me submitted that the relevant DMS market is the national market for the supply of DMS products, and that there is no justification for defining separate customer markets for DMS products provided to franchise and independent dealers. Its key argument, relating to supply-side substitutability, is that DMS providers who currently focus on franchise dealers could easily change their offerings to serve independent dealers.²
12. In terms of demand-side substitution, the evidence suggests that independent and franchise dealers have significantly different needs in terms of what they require from a DMS product. Independent dealers typically require only a 'lite' DMS – without accounting, workshop or parts modules – whereas franchise dealers require this functionality. []³ []⁴

¹ As discussed below, there is likely to be a market for the provision of online motor vehicle classifieds to potential vehicle buyers on the other side of the listings platform, although the focus of our competition analysis is on the market for the supply of online motor vehicle classified advertising to dealers.

² Trade Me's Response to SLOI, 21 November 2017, at [35]-[38].

³ []⁴.

[redacted].⁵ DMS providers also indicated that independent and franchise dealers’ needs are sufficiently different so as to require different products.⁶

13. In considering supply-side substitution, we ask, if prices increased by a SSNIP, whether candidate firms for inclusion in a market would easily, profitably and quickly (generally within one year) switch production to the products or locations in question.⁷
14. The evidence does not suggest that providers of DMSs to franchise dealers would find it sufficiently profitable to switch production so as to be considered in the same market as providers of DMSs to independent dealers. The franchise DMS providers that we have spoken with generally indicated that:
 - 14.1 there would be significant costs involved in providing user support to independent dealers.⁸ Additionally, for some franchise DMS providers, there would be costs in tailoring a product for independent dealers;⁹ and
 - 14.2 the market for DMSs provided to independent dealers is small (relative to the market supplying franchise DMSs), such that investments in these significant costs is unlikely to be recouped.¹⁰ One franchise DMS provider said that entry into the independent dealer DMS market would be “difficult and uncertain”, and it therefore had no appetite to do so.¹¹
15. Therefore, at this stage, the evidence suggests that it is appropriate to define the market as the national market for the supply of DMS products to independent dealers (referred to herein as the ‘DMS market’). However, when considering entry and expansion into the DMS market, we consider whether franchise DMS providers are likely to enter to constrain the merged entity.

Current state of competition in DMS market

16. The evidence suggests that Motorcentral does not face strong existing competition in the DMS market. Its internal documents estimated that it has a market share of

⁴

[redacted].

⁵ [redacted].

⁶ Commerce Commission interviews with [redacted] (14 September 2017); [redacted] (6 October 2017); and [redacted] (26 October 2017); [redacted] (6 December 2017); and [redacted] (7 December 2017).

⁷ Commerce Commission *Mergers and Acquisitions Guidelines* (June 2013), at [3.16].

⁸ For example, [redacted] told us that to do so “would involve a lot of work for no real gain”: Commerce Commission interview with [redacted] (6 December 2017).

⁹ Commerce Commission interviews with [redacted] (6 December 2017); and [redacted] (30 November 2017).

¹⁰ As we discuss below, [redacted] told us that Motorcentral would need to increase its prices to around \$[redacted] a month before it would consider targeting independent dealers: Commerce Commission interview with [redacted] (30 November 2017).

¹¹ Commerce Commission interview with [redacted] (6 December 2017).

independent dealers of approximately []% ([]), which may be an underestimate given that some of the remaining share appears to consist of [].¹²

17. [].¹³ However, other evidence, ([],¹⁴ [],¹⁵ [],¹⁶ []¹⁷) suggests that Motorcentral possesses significant market power and does not face strong existing competition. This suggests that Motorcentral's market share estimates may be reasonably accurate.

18. Evidence from Motorcentral indicates that its key constraint is from potential competition. Motorcentral internal documents [].¹⁸ Motorcentral's explanation for [] was that "[There is evidence that, in the context of [], Trade Me told Motorcentral that [].²⁰ As discussed below at paragraph 58, Trade Me also [].¹⁹

19. Motorcentral also told the Commission that it views [] as a threat.

Dealer classifieds advertising market

20. Websites that display online advertisements are 'two-sided platforms', in that they bring together two distinct types of customer – advertisers and audiences – across the 'platform'. In this case, on the advertising side of a platform, motor vehicle dealers post classified advertisements for their vehicles, which are viewed by potential buyers on the audience side.

¹² []].

¹³ Trade Me Response to SLOI, 21 November 2017, at [42].

¹⁴ Commerce Commission interview with Motorcentral (4 October 2017).

¹⁵

[]

¹⁶].

¹⁷ []].

¹⁷ Commerce Commission interview with [] (6 October 2017).

¹⁸ [], provided by email by Webb Henderson to the Commerce Commission (19 September 2017).

¹⁹ Commerce Commission interview with Motorcentral (4 October 2017).

²⁰ "[], provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

21. These types of platforms are subject to cross-platform feedback loops. An increase in the number of buyers regularly browsing on the audience side makes the platform more attractive for dealers to advertise on; and as more dealers advertise, the platform becomes more attractive to buyers who are likely to benefit from seeing more vehicles on offer.
22. Such feedback loops create an advantage for incumbent platforms, as entrants require a critical mass of customers on both sides to be effective. These feedback loops can also result in the relevant market ‘tipping’ towards a large incumbent platform.
23. For the purpose of our assessment, we note that there are likely to be separate markets for each side of these platforms. In this case, these consist of a market for the supply of online motor vehicle classifieds advertising to dealers with listings to upload on one side of a platform (ie, the dealer classifieds advertising market), and a market for the provision of online motor vehicle classifieds to potential vehicle buyers on the other side of the platform (the audience market).
24. We note that the competition effects of the merger in the dealer classifieds advertising market could also manifest in the audience market (for example, a lessening of competition could result in reductions in the quality of listings platforms, harming potential vehicle buyers). However, on the evidence currently before us, we do not consider that the competition effects in the audience market would be more significant than the competition effects in the dealer classifieds advertising market. Accordingly, our analysis focuses on the competitive impact of the merger in the dealer classifieds advertising market.
25. In evaluating the potential competitive effects of the merger in these markets it is necessary to consider the impact of cross-platform externalities – for example, whether users’ reactions to changes on one side of a platform may constrain the platform provider’s actions towards users on the other side.
26. For instance, in assessing whether an increase in prices to dealers in the dealer classifieds advertising market would be profitable we need to consider whether any revenue gains from price increases would outweigh any revenue losses as result of a potential fall in dealer listings. This requires taking into account whether any fall in listings could undermine the platform’s audience appeal and then further undermine its ability to attract listings and the price it charges for them.
27. As part of this assessment we are considering the degree to which Trade Me faces strong competition from other platforms. This includes considering whether platform users on either side single- or multi-home.
 - 27.1 For example, if audiences have strong preferences to multi-home at several platforms, individual platforms may be unconcerned about negative feedback loops after raising prices on the advertiser side. This is because multi-homing audiences may be less likely to cease visiting a platform with fewer listings. However, if multi-homing is prevalent, platforms may find it harder to charge

advertisers in the first place, or to raise prices, since they would not have unique eyeballs to offer advertisers.

- 27.2 In contrast, if audiences have compelling reasons to single-home at a platform – for instance, if it offers special attractions that its rivals do not have, or if the market has tipped – the platform may be able to charge high prices, and raise them, on the advertiser side, without fearing feedback loops.
28. Our current evidence indicates that large proportions of Trade Me’s audience for motor vehicles may single-home to Trade Me. Trade Me’s audience has been consistently much larger than those of other established listings platforms, such as Autotrader.²¹ Accordingly, Trade Me may be insulated from feedback loops when raising prices to dealers if audience single-homing to Trade Me can be maintained. []²²

Market definition

29. Trade Me submitted that the relevant advertising market is the national market for the supply of motor vehicle advertising to motor vehicle dealers, including both print and digital advertising, and other types of advertisements (classifieds, display, search).
30. Dealer feedback indicates that display and search advertising primarily serve to raise general brand awareness and attract customers to the dealer’s site, whereas classified advertising provides a list of vehicles for sale for customers looking for a specific vehicle. For these reasons, dealers generally did not view display and search advertising as substitutes for classifieds advertising.
31. The evidence suggests that print advertising is not a sufficiently close substitute in order to form part of the same product market as online advertising. Most dealers told us that, while they use print advertising alongside online advertising, these are not substitutes for each other. Some dealers explained that print advertising targets a different audience, such as older or rural demographics. With respect to classifieds in particular, while there is some similarity in appearance between online and print classifieds, dealers said that the ability to search for specific cars on online listings platforms is an important feature that distinguishes online from print classifieds.²³

²¹ For example, Trade Me retains approximately a []x “audience advantage” over Autotrader, and a similar advantage over Driven: “[]”, provided by email by Russell McVeagh to the Commerce Commission (14 September 2017), at 11.

²² “[]”, provided by email by Russell McVeagh to the Commerce Commission (14 September 2017), at 5, 7, 8 and 11.

²³ This feedback is also consistent with the European Commission’s findings in *APW/GMG/Emap*, a case in which the scope of vehicle advertising markets was considered. Although the EC did not conclude on market definition, it noted that “[a]lthough the market investigation has shown that online and offline advertising compete to a certain extent, online advertising could be seen as a separate market. As

Dealers also told us that they tend to use online classifieds to sell cars and print to build brand reputation.²⁴

32. The distinction between print and online advertising generally has been made in previous decisions by the Commission and other competition authorities.²⁵ Trade Me also cited *Google/DoubleClick* in support of its submission that print and online advertising are part of the same market. However, in that case the European Commission concluded that print and online advertising are in separate markets, “primarily because the market investigation revealed that offline and online advertising are perceived as separate markets by the majority of respondents”.²⁶ The European Commission commented that “[a]s opposed to offline advertising, online advertising is considered to be capable of reaching a more targeted audience in a more effective way”.
33. Therefore, we maintain the view that it is appropriate to define the market as the national market for the supply of online motor vehicle classified advertising to dealers (herein referred to as the ‘dealer classifieds advertising market’). We invite Trade Me to provide any further evidence on this issue.

Current competition in the dealer classifieds advertising market

34. Based on evidence provided by industry parties and Trade Me itself, Trade Me appears to have a strong position in the dealer classifieds advertising market, with a high penetration rate among potential vehicle buyers and [] in terms of dealer listings.²⁷ In particular, dealers tend to view advertising on Trade Me as a ‘must have’ product. The evidence suggests that Trade Me may have a market share of up to []% of dealers’ spend on online classified advertising.²⁸
35. Existing competition – mainly from Autotrader and Driven – appears to provide a limited competitive constraint on Trade Me. While Trade Me describes each as [], both have [].

opposed to offline advertising, online advertising is considered to be capable of reaching a more targeted audience in a more effective way” – European Commission Case No. COMP/M.5051, at [27].

²⁴ See for example, Commerce Commission interviews with [] (13 September 2017); [] (15 September 2017); [] (13 September 2017); and [] (12 September 2017).

²⁵ For example, *NZME/Fairfax* [2017] NZCC 8 at [237]–[246]; and Australian Competition and Consumer Commission *carsales.com Limited/Trading Post* Public Competition Assessment (13 June 2013), at [61].

²⁶ *Google/DoubleClick* European Commission Case No. COMP/M.4731, at [45].

²⁷ “[]”, provided by email by Russell McVeagh to the Commerce Commission (14 September 2017), at 5, 7, 8 and 11. See also: “[]”; “[]” and “[]”, provided by email by Russell McVeagh to the Commerce Commission (14 September 2017).

²⁸ This is on the basis of comparing Trade Me’s 2017 revenues from Dealerbase listings and premium services with the revenues that other parties (eg Autotrader, Driven, Drivesouth) made from online dealer classifieds in 2017.

36. There is some evidence that potential competition is, or could be, a constraint on Trade Me.
[].

Role of DMSs in competition between listings platforms

37. There is evidence that DMSs play an important role in competition between listings platforms.²⁹ DMSs can provide a convenient source of a critical mass of vehicle listings to facilitate entry and/or expansion of listings platforms,³⁰ as evidenced by Motorcentral’s Need-a-Car, NZME’s Driven,³¹ Carsales.com.au in Australia,³² and Facebook Marketplace’s recent expansion in the USA.³³
38. We also note that evidence from dealers indicates that, alongside price, easy (‘push of a button’) access to listings platforms is an important factor in choosing where to list.³⁴ Dealers appear to have become accustomed to using the bulk upload function in their DMS to push their listings to platforms.
39. The importance of DMSs to entry in the dealer classifieds advertising market has been recognised by Motorcentral. In one document, where Motorcentral discusses the
[]³⁵ In a document containing Motorcentral’s counterproposal to Trade Me, Motorcentral noted that
“[]”.³⁶
40. Given that most listings are of used cars, DMSs serving independent dealers (which predominantly sell used cars) are likely to be particularly important in this role.

²⁹ Commerce Commission interview with [] (28 September 2017).

³⁰ See for example “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017) and [], provided by email by Webb Henderson to the Commerce Commission (19 September 2017).

³¹ By way of

[]: [] response to Commerce Commission information request (19 September 2017), at 9.

³² Which has a longstanding partnership with Pentana, a DMS. See Commerce Commission interview with [] (28 September 2017).

³³ By way of partnership with DMS providers including CDK Global and Auction123.

³⁴ For example, Commerce Commission interview with [] (18 September 2017).

³⁵ [], provided by email by Webb Henderson to the Commerce Commission (19 September 2017).

³⁶ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

Counterfactual

Summary of preliminary views

41. We continue to be of the view that, absent the merger:
- 41.1 there is a real chance that Trade Me []; and
- 41.2 Motorcentral would remain independent and would continue to develop its Need-a-Car platform.
42. Trade Me submitted that the relevant counterfactual is that []. We continue to consider whether there is a real chance of this counterfactual occurring, and note that the Commission may assess the merger against more than one counterfactual.³⁷ However, we note that we are not currently satisfied that the merger will not have, or would not be likely to have, the effect of substantially lessening competition in the DMS market under this counterfactual as a result of vertical effects. We consider this further below.

The without the merger scenario: Trade Me

43. Trade Me submitted that the counterfactual scenario detailed in paragraphs 8 to 12 of the Commission’s Supplementary Letter of Issues (SLOI) was not supported by the evidence before the Commission. In particular, Trade Me submitted that:³⁸
- 43.1 it is no more than speculation that []; and
- 43.2 even if Trade Me [], it is no more than speculation that such [] would occur in the relevant time period and that [].
44. However, taking into account Trade Me’s submission, we still consider that Trade Me’s internal documents support the view that, absent the merger, there is a real chance that [].
45. The evidence collected to date does not indicate that Trade Me had []. Instead, internal documents indicate that Trade Me was []³⁹ and likely

³⁷ *Mergers and Acquisitions Guidelines*, above n 7, at [2.30]; *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC), at [116], [118].

³⁸ Trade Me’s Response to SLOI, 21 November 2017, at [7]–[29].

³⁹ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

[].

46. Trade Me cites two internal documents recording [], and submits that the documents support that [].⁴⁰ However, those statements are likely coloured by the contemporaneous recommendation to []. [].⁴¹
47. We invite Trade Me to provide additional internal documents to support its submission that it [].
48. Trade Me submitted that [] within two years. Evidence suggests, however, that greater competition [] in the counterfactual could emerge within six to 12 months, based on [] within six months.⁴² As [], that competition is likely to increase in intensity. Trade Me submitted that it would likely [], but Trade Me internal documents suggest otherwise.⁴³
49. We are not yet satisfied that Trade Me would be []. As previously recognised by Trade Me in internal documents, []⁴⁴ with “[]”⁴⁵ from which Trade Me could []. Trade Me is likely to have [], and its []. Additionally, Trade Me is likely to

⁴⁰ Trade Me’s Response to SLOI, 21 November 2017, at [14].

⁴¹ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁴² “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017). See also [] and [].

⁴³ “[]”; and [], provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁴⁴ “[]” provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁴⁵ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

[].

50. Trade Me submitted that [].⁴⁶ However, Trade Me is a firm of substantial size []. An internal document shows that Trade Me has previously considered [].⁴⁷ In any event, Trade Me estimated that [],⁴⁸ whereas Trade Me has []. We invite Trade Me to provide any further evidence on this issue.

The without the merger scenario: Motorcentral

51. We continue to be of the view that, as was submitted by the parties,⁴⁹ in the without the merger scenario, Motorcentral would remain independent and would continue to be active in the dealer classifieds advertising market through its Need-a-Car platform, including continuing to develop and market that platform.

Timeframe for assessment

52. We are considering the appropriate timeframe for assessing the competition effects of the merger.
53. We note Trade Me's assumption in its response to the SLOI that the relevant timeframe to assess the competitive effects of the merger is two years.
54. As the Commission has previously indicated, while we commonly assess competition effects over the short term (up to two years), the relevant timeframe for assessment depends on the circumstances. A longer timeframe will be appropriate if, on the evidence, competition effects are likely to arise in later years.⁵⁰
55. We are considering whether a more appropriate timeframe in this case would be up to four or five years. Part of the vertical effects concerns discussed below relate to the prevention or delay of new entry and, as such, some of the impact on competition of the merger may not materialise until such entry is imminent. Additionally, we note that greater competition [] could take six to 12 months to emerge, which may also justify a longer timeframe over which to

⁴⁶ Trade Me's Response to SLOI, 21 November 2017, at [10]; Commerce Commission interview with Trade Me (24 November 2017).

⁴⁷ "[]", provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁴⁸ "Trade Me Board Paper May 2017", submitted as Confidential Appendix Four to Application, at 19. See also: Application at [9.17(b)].

⁴⁹ Application at [8.9].

⁵⁰ See for example *Vodafone Europe B.V. and Sky Network Television Limited* [2017] NZCC 1 at [21], citing *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [131].

assess the merger. We invite Trade Me’s views on this issue.

Competitive effects in DMS market

56. We continue to test the following two concerns about the impact of the merger on competition in the DMS market:

56.1 *Horizontal effects*: whether the merger is likely to remove actual and potential competition between DealerBase and Motorcentral; and

56.2 *Vertical effects*: whether the merged entity is likely to have the ability and incentive to lessen competition by foreclosing rival DMSs.

57. We discuss these two concerns below.

Horizontal effects

Loss of competition between DealerBase and Motorcentral

58. Trade Me’s []⁵¹
[]
[]⁵² [] DealerBase as competing with
Motorcentral, []. As
mentioned at paragraph 18, Motorcentral views Trade Me [].

59. Internal documents indicate that a key objective of [] is to become more competitive such that Trade Me could “[]”⁵³
[]. For example, the notes from [] record the following comment from the former Head of Trade Me Motors: “[]”⁵⁴
[]⁵⁵

⁵¹ “[]”, provided by email by Russell McVeagh to the Commerce Commission (2 November 2017); “[]” and “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017); “Trade Me Board Paper May 2017”, submitted as Confidential Appendix Four to Application.

⁵² “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁵³ “[]” and “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁵⁴ “[]”, provided by email by Russell McVeagh to the Commerce Commission (2 November 2017).

⁵⁵ “[]”, “[]”, “[]”, provided by email by Russell McVeagh to the

60. Accordingly, the evidence suggests that the
[]
[]
[].
61. As discussed in the counterfactual section, there is evidence that there is a real chance that greater competition [] would emerge within 6 to 12 months []. That competition would be likely to increase in intensity as [].
62. As acknowledged by Motorcentral, its current competitors are [], “[]”,⁵⁶ and Motorcentral []⁵⁷. Given the degree of existing competition that Motorcentral faces, the rivalry between DealerBase and Motorcentral would likely be the main area of competition in the DMS market.
63. We also note that Trade Me’s []⁵⁸. While Trade Me submitted that this is because Motorcentral is currently [], another plausible interpretation is that [].
64. Therefore, we are not yet satisfied that the merger will not have, or would not be likely to have, the effect of substantially lessening competition in the DMS market by removing greater actual competition between DealerBase and Motorcentral. We invite Trade Me to provide any further evidence on this issue.
65. We are also considering whether the loss of the threat of [] (ie. a loss of potential competition) could result in a substantial lessening of competition. As noted above, an important constraint on Motorcentral appears to be the threat of []⁵⁹. As such, the prospect of increased competition [] may be an important constraint on Motorcentral.

Commerce Commission (24 October 2017); and “Trade Me Board Paper May 2017”, submitted as Confidential Appendix Four to Application.

⁵⁶ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017), at 15.

⁵⁷ Commerce Commission interview with Motorcentral (4 October 2017).

⁵⁸ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁵⁹ “Trade Me Board Paper May 2017”, submitted as Confidential Appendix Four to Application; “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

The merger would eliminate that constraint.

Other entry and expansion

66. We assess whether entry by new competitors or expansion by existing competitors is likely to prevent a substantial lessening of competition by considering whether that entry or expansion is likely, and sufficient in extent and timely enough to constrain the merged firm (the LET test).⁶⁰
67. In its response to the SLOI, Trade Me submitted that the merged entity would be constrained by the threat of, or actual, entry and expansion. In support of this submission, Trade Me pointed to Motorcentral's entry in 2011 as an indication that barriers to entry and expansion are low.
68. While evidence of past entry and expansion can assist in understanding the likelihood of future entry, our analysis of the LET test must assess what would be the likely conditions of entry/expansion post-merger. Specifically, would entry and/or expansion by rival DMSs be likely, sufficient in extent and timely enough to constrain an exercise in market power by the merged entity.
69. We are not yet satisfied that entry and/or expansion by rival DMSs is likely to satisfy the LET test.
70. The evidence suggests that entry and expansion following the merger would be unlikely, given the conditions of entry and expansion. We discuss this below. Additionally, a key consideration for us is whether the vertical integration of Trade Me and Motorcentral is likely to make entry and expansion more costly and risky, reducing the likelihood of entry and/or expansion. We also discuss this below.

Evidence on entry and expansion

71. In the SLOI, we noted that entry into the independent dealer DMS market may not be attractive to those with an existing DMS product targeting franchise dealers.⁶¹ We have talked to additional businesses currently offering products to franchise dealers and, consistent with other feedback, those businesses stated that they would be unlikely to enter into the independent dealer DMS market (with indications that their position would be unlikely to change following the merger).⁶² Those businesses indicated that there are greater financial opportunities in other related markets (eg. overseas markets) and in continuing to serve franchise dealers. In particular, we note that [] stated that Motorcentral would need to increase its prices to around

⁶⁰ *Mergers and Acquisitions Guidelines*, above n 7, at [3.95].

⁶¹ Supplementary Letter of Issues, at [18].

⁶² Commerce Commission interview with [] (30 November 2017); Commerce Commission interview with [] (6 December 2017).

\$[] a month before it would consider targeting independent dealers.⁶³
Motorcentral currently charges \$120 a month for its standard DMS product.

72. Trade Me also submitted that existing competitors in the DMS market could expand in response to the exercise of market power by the merged entity. However, Motorcentral told us that its existing competitors are “[]”.⁶⁴ Evidence from another DMS provider to independent dealers also reflects this.⁶⁵ Therefore, we are not yet satisfied that it is likely that these competitors would expand if the merged entity increased the price and/or reduced the quality of Motorcentral.
73. While Trade Me submitted that Motorcentral’s entry and expansion indicates that other entry and expansion is likely, the evidence suggests that the conditions of entry and expansion are different to several years ago when Motorcentral entered. In particular, we have seen evidence that Motorcentral now has a large and sticky installed base of dealers,⁶⁶ and dealers have generally indicated that there are significant switching costs.

Merger may raise barriers to entry and expansion

74. We are testing whether the vertical integration of Trade Me and Motorcentral, in itself, would be likely to raise barriers to entry and expansion. Integration with Trade Me, a ‘must have’ platform for dealers to advertise on, would likely give Motorcentral an advantage which other DMSs are unable to replicate. Such advantages could include, for example, more seamless integration with Trade Me.
75. We are also testing whether vertical integration would give the merged entity the ability and incentive to foreclose rival DMS providers. We discuss whether the merged entity would likely have the ability and incentive to foreclose rival DMS providers in the section below on vertical effects in the DMS market.
76. The merged entity’s ability to engage in such conduct may make entry or expansion significantly less likely, such that any exercise of market power following the merger may not be disciplined.

Conclusion

77. For these reasons, we are not yet satisfied that entry and/or expansion in the DMS market is likely to satisfy the LET test to prevent a substantial lessening of competition. We invite Trade Me to provide any further evidence on this issue.

⁶³ Commerce Commission interview with [] (30 November 2017).

⁶⁴ Commerce Commission interview with Motorcentral (4 October 2017).

⁶⁵ Commerce Commission interview with [] (14 September 2017).

⁶⁶

[]
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Vertical effects

Impact of relevant counterfactual

78. In the factual, the merger will result in the vertical integration of Trade Me and Motorcentral.
79. As noted in paragraph 42 of this letter, we continue to assess whether there are two real chance counterfactuals:
- 79.1 a counterfactual where Trade Me []; and
- 79.2 a counterfactual where Trade Me does not [].
80. In the counterfactual where [], there may be similar incentives to foreclose in the factual and counterfactual once Trade Me has [] – that is, Trade Me would [] in the factual and counterfactual. As such, in both scenarios Trade Me is likely to have the ability and incentive to foreclose rival DMSs. We expect that [] therefore any competition effect due to vertical effects will likely be short-lived. As such, our preliminary view is that any vertical effects under this counterfactual are unlikely to be substantial.
81. Accordingly, we focus only on the vertical effects as compared to the second counterfactual.

Ability and incentive to foreclose

82. We are testing whether Trade Me could profitably foreclose existing or potential DMS competitors by declining to interact with those rivals (eg, by refusing to accept vehicle listings uploads), or by otherwise discriminating against rival DMSs in favour of the Motorcentral DMS. Our view is that there could be many forms of discriminatory conduct, including, for example, imposing charges to interact with the Trade Me platform, delaying uploads, or refusing to provide ROI information.
83. Internal Trade Me and Motorcentral documents suggest that the merged entity would have the ability to engage in such foreclosure strategies:
- 83.1 a Motorcentral internal document states:
 “[]”,⁶⁷ and

⁶⁷ [], provided by email by Webb Henderson to the Commerce Commission (19 September 2017).

83.2 a Trade Me Board document lists []⁶⁸

84. Given the importance to dealers of advertising on Trade Me, and their practice of using a DMS to upload listings to Trade Me, such conduct would likely raise rivals' costs, reducing the likelihood of entry and/or expansion.⁶⁹

85. We are not yet satisfied that the merged entity would not be likely to have an incentive to foreclose rival DMSs. The merged entity's incentive to engage in foreclosure would depend on whether its expected benefits of foreclosure would outweigh the expected costs.

86. Foreclosing rival DMSs is likely to be relatively costless to the merged entity. The main potential cost to the merged entity would likely be reduced purchases of its advertising by dealers using rival DMSs as a result of the reduced access to Trade Me. However, foreclosure is unlikely to cause any material costs to Trade Me, given dealers generally consider Trade Me to be 'must have' and are therefore likely to continue to use Trade Me despite any additional cost and inconvenience. Accordingly, such a strategy could materially worsen the quality of rival DMS products while still preserving sales of Trade Me advertising.

87. In addition to the above, any lost advertising revenues are unlikely to be significant given that:

87.1 existing DMS rivals []⁷⁰ and

87.2 potential entrants not currently active in New Zealand will be serving no dealers.

88. The main potential benefits to the merged entity would be from dealers switching to the Motorcentral DMS⁷¹ [], and from increased pricing power in the DMS market due to the lower threat of entry and expansion.

⁶⁸ "Trade Me Board Paper May 2017", submitted as Confidential Appendix Four to Application, at 22. Trade Me's intention to "[]".

⁶⁹ Raising rivals' costs includes: (a) those costs that are indirect (such as inconvenience or degraded quality/functionality); and (b) imposing the "cost" on consumers (dealers), such that the DMS then needs to compensate the dealer for in order to remain competitive (eg by improving another aspect of price or quality, or by bypassing the cost).

⁷⁰ []

⁷¹ Although this may be limited given that, as noted above, existing DMS rivals serve a small portion of the DMS market (approximately []%).

89. In addition, the merged entity may also benefit from reinforcing a foreclosure strategy in the dealer classifieds advertising market (discussed below). That is, eliminating or weakening competition in the DMS market may make foreclosure in the dealer classifieds advertising market less costly, as dealers' ability to punish the merged entity by switching away from Motorcentral would be reduced.
90. Conduct by the merged entity that raises rivals' costs may make entry or expansion significantly less likely, such that any exercise of market power following the merger may not be disciplined. We note that existing DMS businesses have expressed concern about the possibility of such conduct.⁷²
91. We invite Trade Me to provide any further evidence on these issues.

Competitive effects in dealer classifieds advertising market

92. We continue to test the following two concerns about the impact of the merger on competition in the dealer classifieds advertising market:
- 92.1 *Horizontal effects*: whether the merger is likely to remove the emergence of substantial competition between Trade Me and Motorcentral's Need-a-Car; and
- 92.2 *Vertical effects*: whether the merged entity is likely to have the ability and incentive to lessen competition by foreclosing rival listings platforms.

Loss of competition between Trade Me and Need-a-Car

93. We are considering whether there is a real chance that Need-a-Car would provide a material constraint on Trade Me in the counterfactual, such that the merger is likely to result in a substantial lessening of competition.
94. Trade Me submitted that it is no more than speculation that Need-a-Car "would be the difference between advertising market prices being 5% lower in the Counterfactual than the Factual". In Trade Me's view this is because, in part, Need-a-Car is a new entrant and there are already a large number of other, better resourced, listings platforms in the market (including Driven and Autotrader).⁷³
95. We are continuing to assess whether Need-a-Car's vertical integration with Motorcentral provides it with a competitive advantage over existing, non-vertically integrated, listings platforms. We note that Carsales.com.au told us that, in Australia, its integration with Pentana (a DMS) [] in order for it to become the leading Australian listings platform.⁷⁴ We welcome submissions from Trade Me on why Motorcentral's integration with Need-a-Car would not provide a similar [], such that Need-a-Car is unlikely to become a stronger constraint.

⁷² Commerce Commission interviews with [] (14 September 2017), [] (7 December 2017).

⁷³ Trade Me's Response to SLOI, 21 November 2017, at [3(d)(vii)], [67]–[69].

⁷⁴ Commerce Commission interview with Carsales.com.au (28 September 2017).

96. We also note that Trade Me []⁷⁵ This is despite Trade Me's submission that it is "no more than speculation" to suggest that Need-a-Car could have a significant impact.
97. We invite Trade Me to provide any further evidence on this issue.

Vertical effects

98. We are not yet satisfied that the merged entity would not be likely to have the ability and incentive to foreclose rival listings platforms such that a substantial lessening of competition is likely in the dealer classifieds advertising market.
99. A substantial lessening of competition may arise where foreclosure makes entry or expansion more difficult, or otherwise reduces a competitor's (or competitors') ability to provide a competitive constraint. Foreclosure does not need to force a competitor, or competitors, to exit the market to have this effect. Similarly, foreclosure that delays entry may substantially lessen competition, notwithstanding that entry ultimately occurs.
100. Vehicle listings are essential to a listings platform.⁷⁶ By acquiring Motorcentral, Trade Me would acquire a level of control over a large amount of listings,⁷⁷ and may use that control to make it harder and more costly for existing or potential competitors to obtain those listings. This could make it harder for rivals to compete against the merged entity.
101. In particular, we continue to consider whether foreclosure is likely to hinder or prevent:
- 101.1 competition from existing competitors such as Autotrader and Driven; and/or
- 101.2 potential competition by entrants such as Facebook.

Ability to foreclose

102. In the context of this merger, we consider the term 'foreclosure' to mean any strategies imposed by the merged entity that are likely to raise rival listings

⁷⁵ "Trade Me Board Paper May 2017", submitted as Confidential Appendix Four to Application, at 25.

⁷⁶ Commerce Commission interview with [] (28 September 2017).

⁷⁷

[

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platforms' costs⁷⁸ by raising the costs of receiving listings from dealers using the Motorcentral DMS.

103. Whether the merged entity would have the ability to raise rivals' costs would depend on the extent to which rivals would rely on listings from Motorcentral to effectively compete with Trade Me. As noted above, vehicle listings are essential to listings platforms and dealers upload a large number of listings from Motorcentral. Evidence suggests that these listings are critical to rival listings platforms.⁷⁹
104. There are a number of strategies that the merged entity may be able to implement in order to raise rivals' costs, including:
- 104.1 directly increasing costs [], adding delay to uploads, or restricting the data sent (for example, withholding photos); and
- 104.2 indirectly making it harder for independent dealers to provide listings to rival platforms. For example, the merged entity could remove the option to upload to rival listings platforms from within the Motorcentral DMS.
105. In response to the Letter of Issues, Trade Me submitted that the merged entity would not have the ability to raise the cost of receiving listings. In Trade Me's view, listings platforms have effective counter-strategies to defeat any attempt to raise the costs of receiving listings, including manual data entry and website scraping. Dealers could also continue to send listings to rival listings platforms by using the data export function in Motorcentral (if the option to upload via Motorcentral was removed) or by using an uploading service.⁸⁰
106. We are not yet satisfied that the counter-strategies identified by Trade Me would likely be effective against attempts by the merged entity to raise rivals' costs of receiving listings from Motorcentral. Based on the evidence gathered, we consider that rival platforms would likely incur significant costs implementing Trade Me's submitted counter-strategies, specifically:
- 106.1 manual data entry – Trade Me acknowledged that this would incur costs, but argued that the cost per listing would be fairly low under its assumptions.⁸¹ However, industry parties argue that Trade Me's costs are significant under-estimates, and also that even Trade Me's estimated cost per listing could lead to large total costs since many dealers update their listings frequently;⁸²

⁷⁸ As we note above in our discussion of vertical effects in the DMS market, raising rivals' costs includes (a) those costs that are indirect and (b) imposing the "cost" on consumers (dealers), which would need to be compensated by rival listings platforms.

⁷⁹ []; Anonymous submission to the Commerce Commission (10 August 2017).

⁸⁰ Trade Me's Response to Letter of Issues, 14 September 2017, at [71].

⁸¹ Trade Me's Response to Letter of Issues, 14 September 2017, at [85]

⁸² [], at [5.3]-[5.4].

- 106.2 website scraping – industry parties have told us that this is not a practical alternative to receiving a feed even if Trade Me were not to implement software preventing automated scraping tools from accessing Trade Me Motors data (which it could);⁸³
- 106.3 exporting listings data – Trade Me currently charges a \$49 monthly fee to dealers to access this feature in DealerBase, and could impose a similar charge post-merger for data export from Motorcentral; or it could simply remove the data export functionality; and
- 106.4 using uploading services – AutoPlay’s Data & Web Tools package (an uploading tool) is [] times as expensive as Motorcentral’s DMS product per month.
107. As the implementation of these counter-strategies would likely raise existing rivals’ costs, our preliminary view is that we are not satisfied that they would be likely to prevent the merged entity from having the ability to foreclose.
108. In addition, we are not yet satisfied that the merged entity would not be likely to have the ability to make entry more difficult for potential entrants, including Facebook, such that it would likely reduce entrants’ ability to constrain the merged entity.
109. We understand that Facebook’s overseas expansion in the online vehicle classifieds sector has been facilitated through partnerships with existing, in-market DMSs.⁸⁴ Additionally, Motorcentral explained to us that []:⁸⁵
- []
- []
110. []⁸⁶ We have also seen evidence indicating that Trade Me is contemplating [],⁸⁷ and

⁸³ Commerce Commission interview with [] (22 August 2017); [], at [5.10]-[5.11]; and Commerce Commission interviews with [] (27 and 29 September 2017).

⁸⁴ Facebook Newsroom “Marketplace Adds More Options for US Car Shoppers” (26 October 2017) <https://newsroom.fb.com/news/2017/10/marketplace-adds-more-options-for-us-car-shoppers/>.

⁸⁵ Commerce Commission interview with Motorcentral (4 October 2017).

⁸⁶ “[]”, provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

also that it views [].⁸⁸

111. For these reasons, we continue to have concerns that the merged entity would likely have the ability to foreclose existing and/or potential competitors in the dealer classifieds advertising market. We invite Trade Me to provide any further evidence on this issue.

Incentive to foreclose

112. Whether the merged entity would have the incentive to raise rivals' costs would depend on whether the costs of implementing foreclosure strategies in the DMS market would be outweighed by the expected benefits in the dealer classifieds advertising market.

113. In response to the LOI, Trade Me's views are that:⁸⁹

Trade Me's clear and rational economic incentives are to foster as positive a DMS and advertising platform relationship with vehicle dealers as possible. Trade Me will maximise its revenue by making Motorcentral as attractive as possible to dealers. Any action by Trade Me to restrict Motorcentral's uploading capabilities would simply drive loss of market share for Motorcentral, encourage new DMS entry, and encourage dealers to deepen their direct relationships with other advertising platforms and DMSs.

114. While such foreclosure strategies may, to a degree, make Motorcentral less attractive to dealers, we are not yet satisfied that this means that the merged entity would not have the incentive to engage in such strategies. Rather, we consider that it may be economically rational for Trade Me to engage in such strategies if the potential benefits it expects to derive from gains in the dealer classifieds advertising market outweigh the costs of foreclosure in the DMS market.

115. The main potential cost to the merged entity would likely be a loss of revenue in the DMS market if dealers switch away from Motorcentral in response to a reduction in Motorcentral's quality. However, those costs are likely to be insignificant:

115.1 Choosing not to facilitate listings to Facebook or other entrants is unlikely to result in any cost to the merged entity, as this would not be a reduction in the quality of the current Motorcentral DMS product;

115.2 The costs to the merged entity of foreclosure of existing competitors would likely vary according to the strategy employed. However, some of those strategies, [], would not result in a

⁸⁷ [], provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁸⁸ "Trade Me Board Paper May 2017", submitted as Confidential Appendix Four to Application, at 2.

⁸⁹ Trade Me's Response to Letter of Issues, 14 September 2017, at [121].

reduction of the quality of Motorcentral, and therefore would not be likely to prompt switching; and

115.3 To the extent that any reduction in quality may motivate dealers to switch, there may be few or no viable alternative DMSs, given the prospect that the merger may weaken or eliminate competition in the DMS market, as we discuss above. Importantly, any rival DMSs will likely offer dealers less favourable access to Trade Me, further dis-incentivising switching.

116. Trade Me also submitted that foreclosure strategies would be inconsistent with the [] sale and purchase agreement (SPA). [] ⁹⁰ We note, however, that []
 []
]

117. We are not yet satisfied that the terms of the SPA between Trade Me and Motorcentral [] is likely to remove the incentive for the merged entity to hinder and/or prevent potential entry or expansion into the dealer classifieds advertising market.

118. The main potential benefits to the merged entity would be from dealers switching purchases away from rival listings platforms to the Trade Me platform, and from increased pricing power in the dealer classifieds advertising market due to the lower threat of entry and expansion.

119. We are not yet satisfied that foreclosure would not be likely to prevent or hinder existing and potential competitors’ ability to compete with the merged entity, such that a substantial lessening of competition in the dealer classifieds advertising market is likely.

120. While the evidence suggests that existing competitors currently provide limited competition to Trade Me, they may be constraining more significant price increases.⁹¹ Foreclosure may materially weaken that constraint, enabling the merged entity to charge more in the dealer classifieds advertising market. Additionally, as found in *Rural Press*, even the presence of a “small but potentially significant competitor” “tended to dilute the impact of the existing monopoly”.⁹² As such, a material weakening of the constraint provided by existing competitors raises competition concerns.

⁹⁰ Trade Me’s Response to Letter of Issues, 14 September 2017, at [124].

⁹¹ []

⁹² *Rural Press v Australian Competition and Consumer Commission* [2003] HCA 75, at [46].

121. The foreclosure of potential entrants also raises competition concerns.
 []⁹³
 []⁹⁴ Trade Me estimated that Facebook would likely seek to list vehicles from dealers in New Zealand within two years. Delaying or hindering the entry of a new entrant such as Facebook would likely materially lessen the competitive constraint on the merged entity in the dealer classifieds advertising market.
122. We are considering whether entry/expansion in the dealer classifieds advertising market would prevent a substantial lessening of competition due to foreclosure. However, for the reasons described above, we are not satisfied yet that entry and/or expansion would be likely to prevent a substantial lessening of competition, given that the conduct itself is likely to make entry and/or expansion more difficult.
123. We invite Trade Me to provide any further evidence on these issues.

NZME & Fairfax v Commerce Commission [2017] NZHC 3186

124. On Tuesday 19 December 2017, while Commission staff were preparing this letter, the High Court released its decision in the NZME/Fairfax appeal.
125. We invite Trade Me's views on what impact, if any, that decision has on the Commission's analysis.

Conclusion

126. As set out above, the Commission has not reached any final views on any of the above matter. The purpose of this letter is to give you an opportunity to respond to these concerns.
127. Nevertheless, at this stage, we are not satisfied that the merger would not substantially lessen competition in the relevant markets.

Yours sincerely

Richard Davidson
 Mergers Manager
 Competition and Consumer Branch

⁹³ See for example: [] and [] to the Commerce Commission (14 September 2017); and "[]", provided by email by Russell McVeagh to the Commerce Commission (24 October 2017).

⁹⁴ Trade Me's Response to SLOI, 21 November 2017, at [66].

[], provided by email by Russell McVeagh [], provided by email by Russell