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Commerce Commission

Decision No. 394

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

BP AMOCO PLC

and

BURMAH CASTROL PLC

The Commission:	Mark Berry Paula Rebstock Cathie Harrison
Summary of Application:	The merger of the New Zealand businesses of BP Oil New Zealand Ltd and Burmah Castrol NZ Ltd by virtue of a global acquisition of Burmah Castrol plc by BP Amoco plc.
Determination:	Pursuant to section 66(3) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	26 May 2000

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TABLE OF CONTENTS

TABLE OF CONTENTS 2

THE PROPOSAL 3

THE PROCEDURE 3

PARTIES 3

- BP AMOCO PLC 3
- BURMAH CASTROL PLC 4

BACKGROUND 4

- INDUSTRY 4
- LUBRICANTS 5
- RELATED PRODUCTS 6

MARKET DEFINITION 6

- RELEVANT MARKETS 8
  - *Product market 8*
  - *Functional Market 9*
  - *Geographic Market 10*
  - *Conclusion on the Relevant Market 10*

COMPETITION ANALYSIS 11

- THE MARKET FOR THE MANUFACTURE/IMPORTATION AND SUPPLY OF LUBRICANT OIL 12
  - *Market Concentration 12*
  - *Constraint from Existing Competition 14*
  - *Constraint from Potential Competition 17*
    - Access to Inputs 17
    - Capital Costs 17
    - Product Reputation and Promotion 18
    - Access to Distribution 18
    - Switching Costs 19
  - *The Countervailing Power of Purchasers and Suppliers 20*
  - *Conclusion on the Market for the Manufacture/Importation and Supply of Lubricant Oil in New Zealand 20*

OVERALL CONCLUSION 21

DETERMINATION ON NOTICE OF CLEARANCE 21

THE PROPOSAL

1. In a notice to the Commission dated 5th May 2000, pursuant to section 66(1) of the Commerce Act 1986 (the Commerce Act), BP Amoco plc sought clearance for the merger of the New Zealand businesses of BP Oil New Zealand Ltd and Burmah Castrol New Zealand Ltd by virtue of a global acquisition of up to 100% of Burmah Castrol plc. The acquisition will cause aggregation in the supply of lubricants and related products within New Zealand.

THE PROCEDURE

2. The notice was received and registered on 5 May 2000. Section 66(3) of the Commerce Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of five working days was sought by the Commission. A decision is therefore required by Friday 26 May 2000.

3. The applicant has not sought fact confidentiality for the application, but has requested confidentiality regarding certain facts contained within the application. A confidentiality order has been made for these items because they are commercially sensitive.

4. The Commission's determination is based on an investigation conducted by its staff. In the course of the investigation Commission staff obtained further information from the applicant, as well as from the other major lubricant suppliers, lubricant retailers, and large users of lubricants. These included Mobil, Shell, Caltex, Valvoline, Pennzoil, Fuchs, Challenge, Repco, Kmart, and Industrial Oil NZ Ltd.

PARTIES

BP Amoco PLC

5. BP Amoco PLC ("BP Amoco") is incorporated in Britain and operates worldwide. BP Amoco is a 100% owner of BP New Zealand Holdings Ltd ("BPNZH"), which in turn is a 100% owner of BP Oil New Zealand Ltd ("BP"). BPNZH acts purely as a holding company and does not otherwise carry on business in New Zealand.

6. BP and its subsidiaries operate across all market sectors of the New Zealand petroleum industry. This includes refining, distribution, terminal operations of petroleum products, and retail sales. BP also manufactures, distributes, and retails lubricants, white oils, detergents, and degreasing agents.

7. BP has acknowledged that it has a number of subsidiary companies and other companies within New Zealand, in which it has a significant (20% or greater) share-holding interest. However, the only relevant companies for the purpose of this application are:

    - Coro Trading NZ Ltd (100% owned by BP) which is the company that owns BP's company-owned and operated retail service stations; and,

- McFall Ltd (30% owned by BP) which is a lubricant products distributor operating in the retail market.

Burmah Castrol PLC

8. Burmah Castrol PLC ("Burmah Castrol") is also a British incorporated company operating worldwide. Burmah Castrol is (indirectly) a 100% owner of Burmah Castrol NZ Ltd ("Castrol").

9. Castrol manufactures and distributes lubricants, white oils, detergents, and other cleaning products and degreasing agents. It has five wholly-owned subsidiary companies in New Zealand: Castrol New Zealand Ltd, Fosroc Ltd, South Pacific Lubrication Ltd, Technical Waxes Ltd, and Glamate Ltd. All these companies are non-trading.

BACKGROUND

Industry

10. The four major fuel companies (Mobil, BP, Caltex, and Shell) and Castrol currently account for approximately [ ] of lubricant oil supplied to the market. The fuel companies, in particular, have historically held a strategic advantage in the market over other oil suppliers by being able to tie-in oil sales with their fuel sales. This means that firms that have contracts for fuel with either Mobil, BP, Caltex, or Shell will typically exclusively stock/use that suppliers oil as well. This includes service stations and industrial and commercial users (especially transportation firms).

11. The manufacture/supply dimensions of the industry in New Zealand have undergone significant change within the last five years. Manufacturing operations of oil suppliers within New Zealand have been scaled down considerably. This has seen some companies rationalising to one factory in Auckland, or, in the case of Shell and Mobil, stopping all manufacturing in New Zealand and instead importing from their affiliates in Australia. The Commission has been advised that this trend is likely to continue. The trend towards importing is illustrated by Appendix A. This shows the fall in base oil imports (which is the raw material from which lubricants and related products are made) and the increase of finished products.

12. The way oil is being distributed is changing as well. In the past, for example, most automotive oil was sold at service stations. Service stations, however, are changing; rather than being an automotive pit-stop, with workshops and car products, they are becoming more like convenience stores with a full range of consumer products. Consumers are relying less on service stations for automotive products and are instead going to specialist car product stores such as Repco and Appco. These retailers are known as the "High Street" outlets and also include retailers such as The Warehouse, Kmart, and Deka. It has only been in the last ten years that the fuel companies have sold lubricants to the High Street retailers.

13. Established oil suppliers have also been affected by small players importing cheap, low grade oil. A person can purchase a one-off quantity of oil from overseas and bring it into New Zealand. The oil can then be decanted (by hand) into smaller containers,

labelled, and sold cheaply to High Street outlets. The oil could also be sold quite literally off the back of a truck to local farmers or industries.

Lubricants

14. Lubricants are used in moving mechanical devices mainly to prevent over-heating and to reduce damage from wear. Lubricants also serve to seal machinery against corrosive substances. The lubricant is inserted between the mechanical parts to serve as a "cushion". This reduces friction and allows the surfaces to move smoothly against each other.

15. Most lubricants are derived from crude oil. When crude oil is refined, it is broken down into different chemical compounds. These compounds can be combined in different ways or taken by themselves to form the ingredients for oil-based products. These products include gas, petrol, kerosene, diesel oil, base oils, waxes, and bitumen.

16. The oils from which most lubricants are made are base oils. These base oils can come from the oil refinery in a range of different types and viscosities.[1] The different types are then blended to make the finished lubricant. By varying the proportions of the types, the manufacturing can effect the viscosity of the lubricant to achieve a specific end result. A base oil or blend of base oils is called a "straight mineral oil".

17. Straight mineral oils can be improved through the use of "additives". Different additives can be used to impart new properties or to enhance those properties that the lubricant already has. By altering the additives used and the blends of base oil, a lubricant can be designed to contain the required characteristics for a very specific use; for each application the oil must thin enough to reach areas requiring lubrication yet thick enough to provide sufficient protection. For example, Caltex has over [ ] different types of lubricants available, while BP has around [ ] different products. The majority of these products are designed to serve specific purposes.

18. Base oil is derived from mineral oils but synthetic versions are available. Synthetic oils are created in the laboratory by combining molecules. Because they are manufactured according to a set process in controlled environments, they tend to be of a more consistent nature and free of impurities present in mineral oils derived. Synthetic oils are thus considered to have superior quality and performance to conventional oil, and are typically more expensive.

19. The level of viscosity of an oil is the most important attribute in determining its application. The oil must provide adequate lubrication to all parts without becoming too thick or too thin. Different temperatures affect this viscosity and this must be allowed for. Generally, at high temperatures the oil will become more liquid while at low temperatures the oil will become thicker. The extent to which an oil's viscosity alters with temperature is measured by its viscosity index, or VI; the higher the VI, the less change will occur. Selecting an oil with a sufficiently high VI for the application is important. If the oil is too thick the oil drag can cause the machine to overheat, while being unable to reach areas requiring lubrication. If the oil is too thin it will not provide adequate lubrication at high temperatures or at high pressure.

[1] Viscosity is defined as the thickness and stickiness of the oil.

20. There are two main viscosity classifications. These are SAE (Society of Automotive Engineers) and ISO (International Standards Organisation). The SAE standard is used mainly in the automotive market while the ISO standard is used mainly by industry. A higher SAE classification implies a higher viscosity (thickness). An oil's use therefore, is generally determined by its viscosity, while its quality is gauged by its VI.

21. An oil with just one grade is called a mono-grade, but most oils sold are multi-grade oils. Multi-grade oils have the characteristics of being thinner at low temperatures and thicker at high temperatures than a standard mono-grade oil. The oil might have an SAE classification of (say) 20/40 which indicates the oil will flow as a "20" oil at low temperatures, while flowing as a "40" oil at high temperatures. Multi-grades are superior to mono-grades for this reason.

22. Oil is sold in various quantities depending on the application. Most oil sold to commercial customers is in 205 litre barrels or in larger tanks. In New Zealand, the storage equipment is generally installed by the supplier of oil and can cost upward of $3500 for one site. The burden on the supplier to install the decanting equipment is unusual internationally.

23. The other most common quantity is the 4 litre take-home pack. The 4 litre pack is designed to hold enough oil to fill up an average-sized car, while still having enough for a top-up. Other common quantities in which oil is sold are: 20 litre, 5 litre (for large cars), 1 litre, and 500 ml (for top-ups).

Related Products

24. Along with lubricants oil suppliers will often produce a range of related products to complement their oils. These products include: white oils (such as turpentine, methylated spirits, and kerosine), detergents, and degreasers. These products are all petroleum-based and imported (the main source being Australia). The presence of these products reflects the expectation by consumers that oil suppliers are able to supply the full range of products. These related products do not represent a significant amount of business for oil suppliers, and they will generally supply only a very basic line of products.

MARKET DEFINITION

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

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

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

27. Principles of market definition are contained in *Telecom Corporation of New Zealand Ltd v Commerce Commission*[2], and in the Commission's *Business Acquisition Guidelines*[3] (the Guidelines). These principles are outlined below.

28. Markets have three dimensions: product type, geographical extent and functional level. (In some situations it is also necessary to allow for time, and to consider a temporal dimension.) A market includes products which are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or geographical regions, when there is an incentive to do so because of a change in relative prices. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. Within this space, a hypothetical, profit-maximising, monopoly supplier could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

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

30. Markets are also defined by functional level. Typically, production, distribution, and sale occurs through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next.

31. The most common approach to market definition is to initially concentrate on "demand-side" factors, that is, on purchaser reactions. However, in some instances the Commission may define a market by not only examining demand-side substitutes, but also supply-side substitutes. Supply-side substitutes include all those firms that could change their supply in a timely manner and without significant additional costs or risks in response to a *ssnip* for that product or service. If such firms exist they can be as effective a competitive constraint as demand-side substitutes.[4]

32. Often the boundaries of markets are not clearly defined. The market definition exercise is nonetheless valuable because it is a logical way to organise information for competition analysis purposes. However, if no competition concerns are apparent in markets which may be regarded as artificially narrow, then it is unnecessary to become unduly concerned about the precise boundaries of the market. This is because where there are no dominance concerns within segments of a market, it should follow that no such concerns will arise in wider markets, whatever they may be.

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[2] (1991) 4 TCLR 473.

[3] Commerce Commission, *Business Acquisition Guidelines*, 1999, 11-16.

[4] Baker, S and L Wu, " Applying the Market Definition of the European Commission", European Competition Law Review, 1998, vol 19 no 5, 273-280. See also *Gault on Commercial Law*, para 3.09.

Relevant Markets

Product market

33. The merging of BP and Castrol will cause aggregation across a wide range of lubricant and related products. The Commission has been advised that most of these are specialised in their purpose, and substitution between each type is not generally possible from a demand perspective.

34. One delineation of the market could be by considering the main types of oil. These are:

- Engine;
- Transmission/gear oil;
- Hydraulic fluid; and
- Clean/turbine oil.

35. Although the types of oils described above are the main categories they are not the only ones available. There are many specialised oils which do not fall neatly within any of the types described above. They include grease, two-stroke motor oils, aviation oils, vacuum pump oil, wire rope compounds, brake fluids, and railway engine products.

36. The different lubricants could also be broken down by end users. These would be:

- Automotive - consumer (cars, motorcycles, leisure boats) and commercial (trucks, buses, off-road equipment and other commercially operated vehicle fleets).
- Industrial – examples include metalworking, mining, forestry, power generation, and food processing.
- Marine – all types of shipping, ferries, inland waterways, and the fishing industry.
- Aviation

These are the categories that are generally used by the suppliers to delineate their sales.

37. For the combinations of oil types and users, there are different demands on the oils. Oils have consequently been developed for specific uses and are generally not substitutable. Industrial users, for example, tend to require oil that can withstand extreme conditions, such as high temperature or high pressure. Industrial machinery is often extremely heavy so requires an oil with a much higher viscosity than a consumer product. One of the marine users' main requirements is that the lubricant seals the mechanisms against corrosive substances.

38. In addition to the different groups outlined above, there is also a wide range of quality levels. For example, retail prices for a 4 litre container of consumer engine oil can range between $10 for a cheap mineral mono-grade oil to $70 for a premium synthetic multi-grade oil. The Commission has been advised that from the consumers point of view, a premium quality oil cannot be substituted for a cheap imported oil with an unrecognised brand name. For the owner of an expensive vehicle, using a cheap oil will increase the likelihood of damage caused by wear.

39. It would appear, however, that between premium and cheap oils there exists a "chain of substitutability". That is, for a premium oil there is another grade oil that is "almost as good". If the price rose for premium oils relative to other oils, it would offset the higher quality of the oil. It is likely that the consumer would switch to the slightly lower quality (but now relatively cheaper) oil. This substitutability would be likely to continue right down the quality scale.

40. The acquisition will also cause aggregation in product markets for "related lubricant products". These include detergents, white oils, and degreasing products. These products typically serve specific purposes and are supplied by the firms to complement their range of lubricants. Commission staff have spoken to other suppliers of these related products and have been advised that the merged entities market share is "so small that they are not even monitored". These markets are therefore not considered further.

41. It is recognised by the Commission that for this application there are strong arguments to take account of supply-side substitution at the market definition stage. Notwithstanding the clear differences in products from a demand side perspective, all firms could easily change their production runs or alter their supply chain to target any of the above suggested market segments (automotive, industrial, marine, and aviation). All types of oils are made in almost identical fashion, can be made in the same plant, and differ only in the blends of base oils and additives used. Several manufacturers have advised Commission staff that production of one product could be switched over to produce another very quickly.

42. Enquiries have revealed that there is a wide range of lubricants and related products for different purposes. Within each of these groups of lubricant products there exists a range of different quality levels, which form a chain of substitutability. The users described above have very different requirements for their oils and very little substitution could take place between the various products. It could be argued therefore that there are potentially as many product markets as there are specific requirements. However, the Commission recognises the need to take a pragmatic approach to market definition, and to define markets that best reflects the competitive forces at play. To effect this, the Commission's methodology will be to first look at the segments which are defined by demand-side limitations of the product (automotive, industrial, marine, and aviation) and then look at the wider market that would result from a supply-side approach.

Functional Market

43. Oils go through various functional levels from the production process to the end user. The functional levels of the market relevant to this application are manufacturing/importing and supply, and retailing.

44. The manufacturing level involves blending base oils with additives to produce the lubricant, then decanting it into drums or smaller plastic containers. At present there are only three large scale blending facilities in New Zealand. These are operated by Castrol, BP, and Caltex, and are all situated in Auckland. There are also several smaller plants located around the country.

45. A large proportion of lubricant oil consumed in New Zealand is now imported. Shell and Mobil, for example, import all their oil while Castrol, BP, and Caltex (while manufacturing their main lines in Auckland) still import speciality products.

46. Following the manufacture or importation of the oil, the oil typically will be sold direct to either the retailer or end-user.

47. The other functional level is the retail level. This includes all those outlets which sell oil to the public. The main source of oil sales are the High Street outlets, car workshops, and service stations. Typically, fuel suppliers will tie in oil and other related products with the contracts to supply fuel. It is currently unusual to see any oil products other than those of the fuel supplier at a service station. In this way, BP is represented at the retail service stations. Castrol only supplies its oil at the manufacturing/importation level, so no aggregation will occur at the retail level. In view of this, the Commission will not analyse the market at the retail level.

48. The Commission concludes that the functional market relevant to this application is for the manufacture/importation and supply of lubricant oil to retailers.

Geographic Market

49. The applicant has submitted that the geographical market is New Zealand. The Commission's investigation suggests that this is the most appropriate definition of the geographical market.

50. Oil is a heavy, high value product which can be transported relatively cheaply compared to its sale value. The Commission has been advised by that the average cost of shipping a litre of oil from Australia to New Zealand is between 20-30¢. This litre will then be on-sold for an average of around $3-$3.50 depending on the type of lubricant.

51. All domestic manufacturing by BP, Caltex, and Castrol is done in Auckland and distributed from there to distribution centres throughout the country. Oil producers have had blending facilities situated throughout New Zealand in the past but found it is more economical to produce all oil out of one site and distribute from there. The oil is usually shipped to the South Island but [ ] has noted that oil can also be transported by road to anywhere in the country with 24 hours if a shortage arises.

52. The Commission has concluded that the geographical extent of the market is New Zealand-wide.

Conclusion on the Relevant Market

53. The Commission concludes that, from the information provided, the relevant functional/geographical market is the manufacture/importation and supply of lubricant oil in New Zealand.

54. With regards to the product market, the Commission concludes that a rigid definition of the market is not necessary for the purposes of this application. Instead, market power

will be examined using a demand perspective considering four product categories, and then using the broader supply-side approach once the narrower markets have been assessed for competition issues.

55. The demand-side delineations to be considered are:

- Automotive;
- Industrial;
- Marine; and
- Aviation.

The supply-side product market encompasses the wider lubricant market.

COMPETITION ANALYSIS

57. Competition analysis assesses competition in the relevant markets, in order to determine whether a proposed acquisition would result, or would be likely to result, in the acquisition or strengthening of dominance. Section 47 of the Commerce Act proscribes a person acquiring the assets of a business or shares where as a result:

> That person or another person would be, or would be likely to be, in a dominant position in a market: or
>
> That person's or another person's dominant position in a market would be, or would be likely to be, strengthened.

58. The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Read in conjunction, sections 66(3) and 47(1) require that, where the Commission is satisfied that a proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not so satisfied, clearance must be declined.

59. In his judgment in *Commerce Commission* v *Port Nelson Limited*[5], McGechan J included the following statements[6]:

> 'Dominance' includes a qualitative assessment of market power, It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a high degree of market *control*.
>
> How high? Clearly, not absolute control. There need not be monopoly. There need not be an ability to act totally without regard to competitors, suppliers, or customers….(However), (t)he firm must be able to set terms of trading independently of significant market constraints. It must be able to set prices or conditions without significant constraint by competitor or consumer reaction. (Emphasis in original.)

60. The Commission's *Business Acquisition Guidelines* also recognise that dominance involves a high degree of market power. The Guidelines reflect that for a firm to be dominant it must have the power to behave in a manner different from that which a competitive market would allow. The *Guidelines* (paragraph 7) state that:

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5 (1995) 6 TCLR 406.

6 Ibid, 441-42. This test was affirmed by the Court of Appeal in *Port Nelson Limited* v *Commerce Commission* [1996] 3 NZLR 554, 573.

> A person in a dominant position in a market will be able to set prices or conditions without significant constraint from competitor reaction.
>
> A person in a dominant position will be able to initiate and maintain an appreciable increase in price, or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long run.

61. As the *Port Nelson* judgment highlighted,[7] the analysis of dominance must centre upon the provisions of section 3(8) of the Commerce Act. In relation to section 47, the relevant provisions are contained in section 3(9). The section requires that regard be had to three groups of factors:

> The share of the market, the technical knowledge, the access to materials or capital of that person or that person together with any interconnected body corporate:
>
> The extent to which that person is constrained by the conduct of competitors or potential competitors in that market:
>
> The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

62. The weight that will attach to each of these considerations will vary from case to case. As Richardson P noted in *AMPS A:*[8]

> (Section 3(9)) does not allow any theoretical or intuitive ranking applicable in all cases. It proceeds on the premise that the weighting must vary according to the particular facts. It calls for a pragmatic assessment in the particular circumstances of one's ability to exercise a dominant influence in one or more aspects of the relevant market.

63. In relation to the present application, there will be significant aggregation of business activity in the area of the supply of lubricant oils. From a demand side perspective, there are four product categories where aggregation in business activity will occur. From a supply side perspective, a wider "lubricant oil" market can be identified. A competition analysis will be conducted considering both of these approaches.

The Market for the Manufacture/Importation and Supply of Lubricant Oil

Market Concentration

64. The degree of concentration of market share which would result from a business acquisition is a useful first indication of the likely degree of market power which might follow, and this is recognised in the "safe harbours" that are defined in the Commission's *Business Acquisition Guidelines*. These safe harbours recognise the importance of both the absolute levels of market share, and the distribution of these shares.

65. The *Guidelines* state (paragraph 4.3):

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[7] Ibid, 442-43.

[8] *Telecom Corporation of NZ Limited* v *Commerce Commission* [1992] 3 NZLR 429, 444.

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

66. Other things being equal, the higher the market share resulting from a business acquisition, the higher is the likelihood that dominance would be acquired or strengthened. However, conclusions cannot be drawn on market shares alone. As outlined above, the effect of section 3(9) of the Commerce Act is that market share is but one of a number of factors to be taken into account in reaching a view on dominance. The relative weight of these factors must be assessed in each market, which is being examined, but the significance of market share could be outweighed by the other elements, especially the nature of entry conditions.

67. In the market for the manufacture/importation and supply of lubricant oil in New Zealand the product range is broad, with a large number of product lines within the range. The main groups of products are: automotive; industrial; marine oil, and aviation oil, with automotive oils representing the largest part of the market. The estimated shares of these possible markets are outlined below in Table 1.

Table 1

The Estimated Shares of each Lubricant Oil Product Category

	Automotive		**Industrial**		**Marine**		**Other***	
	(ML)+	(%)	(ML)	(%)	(ML)	(%)	(ML)	(%)
BP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Castrol	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Merged Entity	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Mobil	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Shell	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Caltex	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Fuchs	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Valvoline	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	[ ]	100%	[ ]	100%	[ ]	100%	[ ]	100%

Source: Suppliers to the Market as checked against Statistics New Zealand.

*This category includes Aviation oil.

+ Millions of litres.

68. Estimated market shares using the broad approach, are outlined below in Table 2.

Table 2
The Estimated Market Shares for the Manufacture/Importation and Supply of Lubricant Oils Market

Supplier	Volume (millions of litres)	Market Share (%)
BP	[ ]	[ ]
Castrol	[ ]	[ ]
Merged Entity	**[ ]**	**[ ]**
Mobil	[ ]	[ ]
Shell	[ ]	[ ]
Caltex	[ ]	[ ]
Fuchs	[ ]	[ ]
Valvoline	[ ]	[ ]
Glydol	[ ]	[ ]
Pennzoil	[ ]	[ ]
Other	[ ]	[ ]
Total	**[ ]**	**100%**

Source: Suppliers to the market as checked against Statistics New Zealand

69. The product category shares for the narrow approach to market definition and those for the wider defined market are all within the Commission's safe harbour guidelines.

Constraint from Existing Competition

70. The market for lubricant oil is mature with the average age of the New Zealand car reducing and their engines becoming more efficient. Industrial machinery is also becoming more efficient resulting in longer oil cycles. The demand for oil is therefore stable, approaching decline. The market is characterised by a large number of branded products, which are distributed in different ways.

71. Automotive oil is distributed through retail outlets such as service stations, large department stores and speciality stores, and by direct supply to the customer in the case of large car dealerships, workshops and trucking businesses. There is a trend away from purchases from service stations to purchases from large department stores and speciality stores selling 4 litre and 5 litre "take home" packs. These outlets characterised as "High Street" outlets, represent an increasing proportion of retail sales of lubricant oil. Service stations, especially in larger centres, provide a convenience function for consumers and are becoming less involved with providing mechanical services.

72. Industrial, marine, and aviation oils are generally distributed direct to the customer by the supplier through bulk supply in the form of "on site" storage facilities or by the provision of large 205 litre drums.

73. Historically, all of the major oil companies each had several "blending" facilities in New Zealand. However these were rationalised as transportation became more efficient, and production centralised to achieve efficiencies.

74. Approximately half of all lubricant oil supplied to the New Zealand market is "blended" locally in Auckland. BP, Castrol and Caltex all have blending facilities which generally produce the higher volume products such as automotive and industrial oils. Mobil and Shell used to produce lubricant oils in New Zealand, however they rationalised their production facilities, and now import most of their product from Australia. [

]. All other suppliers to the market import their product.

75. The merged entity would face effective competition from the other oil company majors, Mobil, Shell and Caltex, from Fuchs, and also from the smaller suppliers of the *Valvoline, Glydol,* and *Pennzoil* brands. Mobil, Shell and Caltex are all large multi-national vertically integrated oil companies with a strong market presence throughout New Zealand. They are represented across the product range, and all provide product in different price points within each range. These companies all have strong national distribution systems. Automotive products are distributed through their large network of service stations and also through large specialty stores such as Repco and Appco. Other product types are distributed direct to the customer through the provision of "on site" storage equipment.

76. Mobil, Shell and Caltex all invest in their brands which have a good brand recognition in the lubricant oil market. There is a degree of brand loyalty at the high end of the market, but demand is sensitive to price.

77. Mobil, Shell and Caltex all have a research and development capability and also the ability to obtain economies of scale in production and marketing. These three competitors currently offer effective competition to the merger parties, and would be able to constrain the merged entity if it attempted to exercise market power by increasing the price of the product. These competitors could increase supply to the market by increased importation, or in Caltex's case, the increased utilisation of existing capacity.

78. Competition at the retail level of the market is intense. An increase in the retail price of a product would result in a reduction in quantity demanded for that product. This constrains a supplier wishing to increase the price to the retailer. Switching costs are low for consumers and supply to commercial customers is generally the subject of supply contracts which are contestable. Larger contracts may involve an investment by the supplier in storage equipment which may cost around $3,500 per site. The nature of these contracts do increase switching costs, but these supply arrangements are reviewed regularly and the business is contestable.

79. Large commercial customers such as trucking firms require both products in large volumes. The oil company "majors" have an advantage over smaller suppliers of lubricant oil because of their ability to supply fuel and other related products such as lubricant oil at competitive prices to commercial customers.

80. The oil company "majors", through their access to capital, also have an advantage over smaller suppliers in contesting larger commercial contracts. These "majors" will provide benefits such as "pre paid discounts", which are capital payments made to the purchaser at the commencement of the term contract, and they will provide allowances for such things as bulk storage equipment.

81. Fuchs Australia Pty Limited is a subsidiary of Fuchs Petrolub AG, a large multi-national specialty producer and supplier of lubricant oil, with a presence in many countries. It produces a broad range of lubricant oil products which compete with the major international brands. In the 4 years since its entry into New Zealand, it has grown its sales to [ ] or about [ ] of the wider market. Fuchs distributes automotive oil through specialty stores and "High Street" retailers, whilst it distributes its industrial products direct to its large customers, which include [ ]. Its product mix is approximately [ ]. Fuchs is anaggressive competitor in the market, and since its entry the average price of standard lubricant has decreased.

82. Fuchs has access to research and development competencies and an independent supply of the product through its parent company. It is currently supplied from its Australian blending facility, which it imports in 'saleable' containers. Fuchs is currently offering effective competition in this market and is capable of constraining the behaviour of the merged entity if it attempted to increase prices.

83. The next group of competitors are smaller and tend to focus on the high volume products such as automotive oils. These competitors include D.R.Britten Limited, which supplies the Valvoline brand and Pennz-corp, which supplies the Pennzoil brand through retail outlets and through bulk supply direct to the customer.

84. D.R. Britten Limited, is a well established family business which has been supplying the *Valvoline* brand since the 1950's. It has an established distribution network and supplies specialty retail stores and independent service stations with a range of consumer products. It also supplies workshops and other commercial customers through bulk supply. Pennz-corp distribute the *Pennzoil* brand to a network of "workshops" and retail outlets. Both of these competitors have the ability to increase their supply of lubricant oil to the market. They are both domestic suppliers for large multi-national oil companies and could expand their product range if there was an economic incentive to do so.

85. Industrial Oil NZ Ltd is a Christchurch-based blender of oil. It is an established business who supply mainly industrial oils on a national basis. It supplies under the *Glydol* brand and the business could increase supply by utilising excess capacity.

86. There is also a large number of other branded lubricant oil products supplied to the market by smaller independent suppliers, such as Elf Lubricants NZ Limited and Aegis Oil Co Limited. These smaller brands include *Agip, Aegis,* and *Elf.* These brands are represented at different price points in the market, and generally relate to particular product types. These competitors could be characterised as smaller fringe competitors.

87. It is the Commission's view that existing competition will continue to provide a significant competitive constraint on the merged entity.

Constraint from Potential Competition

88. A business acquisition is unlikely to result in the acquisition or strengthening of dominance if there is a credible threat of market entry. Potential competition can act as a constraint on market power, and so an examination of the nature and extent of this constraint is part of the Commission's assessment of competition.

89. Entry conditions, including the nature and height of any entry barriers, must be considered before the threat of new entry, which might constrain the conduct of a merged entity, can be evaluated.

Access to Inputs

90. To supply the market with lubricant oil, a potential entrant would require access to a supply of lubricant oil either through importation or through domestic manufacture. Globally, there is excess capacity in the production of lubricant oil, with capacity utilisation being about 50%. Access to a supply of oil is not a barrier to entering this market, assuming these production facilities have access to a steady supply of base oil. There are also no economic barriers to importing the product, with imported product competing effectively with domestically produced product. The oil supplied, could be a global brand (*Valvoline, Fuchs, Elf,* and *Pennzoil*) or a regional brand, and a local brand could be created. Branding is an important factor in selling the product.

91. The alternative to importing is to produce the product domestically. However this involves a large capital investment and would require a reasonably large share of the market to achieve efficiencies in production. This would not be a good strategy for a new entrant. The trend is towards centralisation of production to achieve economies of scale, with production facilities in Australia, Asia and the United States supplying the New Zealand market.

92. Domestic production would also require access to base oils and additives which are the inputs to lubricant oils. Currently base oil is supplied to New Zealand from Australia, with all of the oil "majors" supplying the product, along with other independent suppliers. Supply could be obtained from one of these "majors" to supply a New Zealand production facility. [

]. The global supply of additives is not concentrated and additives are freely available.

Capital Costs

93. The importation of lubricant oil would not require a large capital investment. An investment in stock and storage facilities would have to be made, but this level of investment would not be onerous. The sunk cost component of this investment would be very low. The most basic business model would be; importing a container of lubricant oil in saleable packaging, storing and selling the product through direct sales.

94. The investment in a local production facility to "blend" lubricant oil would require capital of between $10-15m, most of which would be sunk. Such a facility requires a large amount of plant and equipment in the form of storage tanks, pipelines and production lines. Such facilities have to be close to a port to allow for base oil to be pumped from supply ships. However these 'infrastructure' investments have long economic lives and do not require a high level of maintenance expenditure. Processes such as storage and distribution can be out-sourced reducing capital costs. However, a local production facility is not essential for entry into this market as importation is economically viable.

95. The capital cost of entry through domestic production and supply can be regarded as moderate, however a local production facility is not essential to supplying the market. Barriers to entering this market are considered to be low.

Product Reputation and Promotion

96. Firms may seek a point of difference for their products by differentiating them from rival offerings. Product differentiation can be based upon physical differences in product attributes, differences in physical locations, differences in the level of service or in terms of the subjective image the goods impress on the consumers mind.[9] Established products in a market may enjoy consumer acceptance and preference because of consumer satisfaction or repeated advertising over time. Many buyers prefer the products of known or tried firms over those of new firms of which less is known. This is especially so when quality is neither apparent or cheaply sampled. An entrant may have to charge less or advertise more than incumbents.[10]

97. On the facts of the present case there is a proliferation of brands across the various product characteristics, and such a "space-packing" strategy by the incumbent firms may deter sizeable entry.[11] Evidence from market participants suggests that there is a degree of brand loyalty especially with premium quality products. The market is price sensitive, and there are a number of substitutable products within each of the price point ranges.

98. In the present case it appears that the cost of establishing brand loyalty and reputation can be regarded as a potential barrier to entry, particularly with premium quality products. However, as the *Fuchs* example illustrates, if the brand is well positioned this can result in the entrant gaining market share.

Access to Distribution

99. The largest retail outlets in this market are large "High Street" discount stores, speciality retailers and service stations. Because of the integrated nature of the oil company "majors", it would be difficult to get product into service stations owned by these "majors". However, the product could be distributed through these other high volume outlets.

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[9] F M Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd ed, Houghton Mifflin Company, Boston, 1990) 571.
[10] P E Areeda, H Hovenkamp, and J L Solow, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Vol IIA, Little, Brown and Company, 1995) 68-69.
[11] Op cit note 9, at 406.

100. Distribution to the high volume commercial and industrial users would be more difficult because of the access to the capital resources the oil company “majors” have. As discussed above in paragraph 79-80**,** these companies provide large purchasers with benefits such as equipment allowances and pre-paid discounts to assist them in securing the business. To compete effectively, a new entrant would require access to a large amount of capital to provide such benefits. Large international companies such as *Fuchs* have access to such capital.

101. Fuchs Australia Pty Ltd, is an example of the recent entry of an international brand. It entered the market 4 years ago via acquisition, and since that time has established a brand presence in the market, and has a [ ]. It has access to capital resources and is competing effectively in the market.

102. Another example of recent entry into this market is the entry of the *Elf* brand, which is an international brand. This brand is distributed in New Zealand by Elf Lubricants NZ Limited, which entered the market in 1997 via a greenfields operation and distributes predominantly automotive product. The brand is a higher quality, higher price point product which is distributed through workshops and specialty stores including Gull service stations. [

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103. Challenge Petroleum Limited is a large retail outlet for lubricant oil suppliers. It is currently being supplied by Castrol. Its supply contracts are reviewed frequently and its business is contestable. An efficient supplier of lubricant oil could gain access to this distribution outlet.

104. Access to high volume retail outlets is not a barrier to entering this market. However, access to larger commercial and industrial purchasers by small suppliers, is limited by their access to capital and the ability to also provide fuel. However there are several independent fuel suppliers (Challenge, Gull), whom a smaller lubricant oil supplier could establish a business relation with to contest these larger contracts. Such entry conditions do not impose high entry barriers.

<u>Switching Costs</u>

105. The switching costs for purchasers can be significant and a barrier to entering the market for certain types of entrants. These entrants are small suppliers of lubricant oils who cannot provide the supply incentives such as pre-paid discounts and storage equipment allowances that the larger companies can. Furthermore, large purchasers would be faced with increased lubricant oil costs by not tying in their lubricant purchasers with fuel. However, these costs do not impose an entry barrier to other large vertically integrated suppliers. The recent entry into the market of Fuchs provides evidence of this.

106. Overall, therefore, the Commission concludes that potential entry provides a competitive constraint on the merged entity.

The Countervailing Power of Purchasers and Suppliers

107. Retail suppliers who purchase lubricant oil can be characterised as large “High Street” retail discount stores such as K mart, Deka, and The Warehouse, service stations and speciality automotive stores such as Repco and Appco. There are also large commercial and industrial users. Some of these purchasers are multi-brand suppliers, whilst others are not and may not readily become multi-brand suppliers because of their integrated and “tied” structure. Clearly, such suppliers would have little countervailing power.

108. There is a concentration of purchasers, particularly with regards to retail purchasers which operate large networks of retail outlets. For example, Repco, an automotive specialty store, has a network of 90 stores. This concentration of purchasers provides them with a degree of countervailing power that could constrain any attempt by the merged entity to exercise market power by raising prices. Switching costs are low and there are a number of suppliers who could supply these purchasers with extra volume.

109. Large industrial users (Comalco, Fletcher Challenge, BHP New Zealand Steel) are concentrated and also possess some countervailing power.

110. It is the Commission’s view, that there is a degree of countervailing power held by large purchasers of lubricant oil, that could constrain the behaviour of the merged entity.

Conclusion on the Market for the Manufacture/Importation and Supply of Lubricant Oil in New Zealand

111. In adopting either a narrow or wide market definition, the merged entity would have market shares that are within the Commission’s safe harbour guidelines.

112. The merged entity would face effective competition from existing competitors, who would offer a significant competitive constraint to the behaviour of the merged entity. The largest of these entities are vertically integrated oil companies, who compete with the merged entity across the product range. While switching costs faced by large purchasers impose barriers to entering the market for small suppliers, barriers to entering this market are not considered to be onerous for large vertically integrated suppliers. Therefore, overall, the threat of entry could constrain the behaviour of the merged entity.

113. There is a degree of concentration amongst purchasers, especially the purchasers of the high volume automotive products. This degree of concentration provides these purchasers with a degree of countervailing power if the merged entity attempted to exercise market power by raising prices.

114. On the basis of the matters discussed above, the Commission concludes that BP Amoco is not currently dominant in the market for the manufacture/importation and supply of lubricant oil in New Zealand, and would not be likely to acquire a dominant position in this market as a result of the proposed acquisition.

OVERALL CONCLUSION

117 The Commission has considered the likely impact of the proposal in the market for the manufacture/importation and supply of lubricant oil in New Zealand.

118 Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the manufacture/importation and supply of lubricant oil in New Zealand.

DETERMINATION ON NOTICE OF CLEARANCE

119 Accordingly, pursuant to section 66(3)(a) of the Act, the division of the Commission determines to give clearance for the proposed acquisition by BP Amoco plc of up to 100% of the shares in Burmah Castrol plc.

Dated this 26th day of May 2000

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M N Berry
Deputy Chair