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COMMERCE COMMISSION

Decision No. 482

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

CENDANT CORPORATION

and

BUDGET GROUP INCORPORATED

The Commission:	MJ Belgrave PR Rebstock D Bates QC
Summary of Application:	The Cendant Corporation has sought clearance to acquire up to 100% of the shares in Budget Group Incorporated
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	6 November 2002

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THE PROPOSAL

1. A notice pursuant to section 66(1) of the Commerce Act was received on 4 September 2002. The notice sought clearance for the acquisition by Cendant Corporation ("Cendant") and/or any of its interconnected bodies corporate of up to 100% of the shares in Budget Group Incorporated ("Budget") and/or any of its interconnected bodies corporate; and/or any or all of the assets of Budget and/or any of its interconnected bodies corporate.

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Extensions of time were sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 17 October 2002.

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

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

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

THE PARTIES

Cendant

6. Cendant is a diversified global provider of business and consumer services primarily within the travel and real estate sectors. Cendant has its headquarters in New York and is listed on the New York Stock Exchange.

7. In New Zealand, Cendant operates in the following principal segments:

    a) vehicle services: trading as Avis Rent a Car Limited, a vehicle rental business;

    b) travel distribution: where Cendant operates Galileo and WizCom;[2]

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

[2] Cendant also owns and operates the www.trip.com and www.cheaptickets.com websites, however these websites require a United States credit card and mailing address.

c) hospitality services, where Cendant owns and operates hotel brands, timeshare exchange services, travel agency and cottage rental businesses, including the Howard Johnson, Days Inn, Travelodge, Ramada and Resort Condominiums brands;

d) real estate services, where Cendant owns and operates real estate brands and mortgage and relocation businesses, including the Century 21 and Cendant Mobility brands (the latter in New Zealand via an independent contractor); and

e) financial services, where Cendant operates insurance-related and tax preparation services businesses (including the Benefit Consultants Inc, and Jackson Hewitt brands).

8. Cendant is the parent company of Avis Group Holdings, Inc., which owns Avis Rent A Car System, Inc., a US operating entity. Avis Rent A Car System owns Avis International, Ltd., which in turn owns Avis Asia and Pacific Ltd. Avis Asia and Pacific Ltd. owns and operates Avis Rent A Car Limited (New Zealand).

9. The "Avis" brand is present in the market via two means:

   a) Avis New Zealand's "Corporate" locations, which are either:

      (i) owned, operated and staffed by Avis New Zealand; or

      (ii) agencies – which use Avis New Zealand vehicles, but which are staffed and managed by the agent; and

   b) franchised operations – which have their own vehicle fleet and run their own business. As of 2001, Avis New Zealand's franchised operations operated a fleet of **[ ]** vehicles.

10. Avis New Zealand has 10 independent franchisees (with 18 locations), 8 agencies (with 13 locations) and 8 corporate branches (i.e. owned and controlled by Avis New Zealand, with 10 locations in New Zealand). Avis currently has booths at Auckland, Christchurch and Wellington International Airports.

11. Avis New Zealand has a fleet that ranges in size from approximately [ ] in summer to [ ] vehicles in winter. As at 18 September 2002, the Avis fleet consisted of [ ] rental cars. Avis leases new vehicles for a period of [ ] months, which makes up [ ] of their fleet, while the remaining [ ] are owned by Avis.

Budget

12. Budget is a public company. It has a presence in 120 countries and territories. Budget and its subsidiaries are engaged in the business of the short-term rental of vehicles, trucks and vans (through both corporate owned and franchised operations). Budget Rent a Car Limited is owned, via a number of wholly owned subsidiaries, by Budget Group Inc., a United States-based company. 17 of Budget New Zealand's 50 outlets are owned and operated by franchisees, the remainder are wholly owned by Budget New Zealand (via agencies in Gisborne, Taupo and Timaru). Budget New Zealand's franchisees collectively

operate a fleet of [ ] vehicles. Budget currently has booths at Auckland, Christchurch and Wellington International Airports.

13. Budget filed for Chapter 11 bankruptcy in the United States on July 29, 2002. Budget has suffered consecutive annual losses for the last four years starting in 1998. At the end of 2001, Budget had debt outstanding of approximately USD 3.5 billion.

14. In New Zealand, Budget has a fleet that ranges in size from approximately [ ] vehicles in summer to [ ] vehicles in winter. As at 18 September, the Budget fleet consisted of [ ] rental cars. Budget leases vehicles for a period of [ ] months.

OTHER RELEVANT PARTIES

Hertz

15. Hertz is the world's largest car rental company, operating from over 7000 locations in more than 150 countries. Hertz is a wholly owned subsidiary of the Ford Motor Company. Hertz New Zealand is a wholly owned subsidiary of the Hertz Corporation. Hertz offers a wide variety of current-model cars on a short-term rental basis at airports, in downtown and suburban business centers, and in residential areas and resort locales. Hertz currently has booths at Auckland, Christchurch and Wellington International Airports.

16. In New Zealand, Hertz has a fleet that ranges in size from approximately [ ] vehicles in summer to [ ] vehicles in winter. As at 18 September 2002, the Hertz fleet consisted of [ ] vehicles.

17. Hertz leases vehicles from a range of companies, [ ]% of which are leased from their parent company Ford motors. Hertz typically leases vehicles for a period between [ ] months, of which the bulk are leased for [ ] months.

Thrifty

18. Thrifty operates in 60 countries and territories with more than 1300 locations throughout North, Central, and South America, Africa, Europe, the Middle East, the Caribbean, Asia and the Pacific. Thrifty is by strategy a franchise system. More than 90% of its retail outlets worldwide are owned by independent businesses licensed to use the Thrifty trade name, systems and technologies.

19. Since November 1999, the Thrifty franchise for New Zealand has been operated by Rental Cars Ltd, a wholly owned subsidiary of Flexi Auto Lease, which is itself a wholly owned part of the South Canterbury Finance Group of companies, who are wholly owned by the Southbury Group Limited.

20. In New Zealand, Thrifty has a fleet that ranges in size from approximately [ ] vehicles in summer to [ ] vehicles in winter. As at 18 September 2002, the Thrifty fleet consisted of [ ] vehicles. Thrifty was successful in tendering for booths at Christchurch and Wellington International Airports.

21. Thrifty leases new vehicles from its parent company, Flexi Autolease Ltd, usually for a period of [ ] months.

National

22. National Car Rental has been operating in New Zealand since 1992. National is one of the largest car rental operators in the world, with over 3000 locations in 70 countries, including the United States, Australia, United Kingdom, South America, the Middle East and Europe. National Car Rental New Zealand is [ ] owned by Europcar Australia and [ ] owned by Phillip Barnett, with Mr Barnett holding the company's management rights. The Europcar brand is wholly owned by Volkswagon (Germany) and is present in a large number of countries (with the exception of the US).

23. National Car Rental has expanded rapidly in New Zealand since 1992 and provides a nationwide network of 16 depots and locations throughout New Zealand. National currently has a booth at Auckland International Airport.

24. In New Zealand, National has a fleet that ranges in size from approximately [ ] vehicles in summer to [ ] vehicles in winter. National leases new vehicles for a period of [ ] months.

Apex

25. Apex is New Zealand's largest independently owned car hire company, and operates through a network of 6 locations throughout New Zealand.

26. Apex operates a summer vehicle fleet of over [ ] cars. As at 18 September 2002, Apex had a rental fleet of [ ] vehicles. Apex owns its own vehicles, which consist of a mixture of used Japanese imports and [ ] new cars, both of which are typically retained for a period of [ ] years. It has been increasing the proportion of the new cars in its fleet for the last three years.

27. Apex does not have any airport booths but has free phones at each of the airport terminals and licenses that allow it to pick up and drop off customers. It does not target the corporate market. [ ] of its bookings are done through the Internet.

INDUSTRY BACKGROUND

28. The tourism industry generally refers to the car rental industry as being in the business of hiring motor vehicles, without the services of a driver or under a hire purchase agreement, for an agreed price.

29. Car rentals are a transport option for leisure and business travellers. The typical business hire is for a period of 2 days, while the typical leisure hire ranges over a period of 6 to 8 days, depending on whether a booking was made on a retail basis (directly from a car rental company) or through a travel wholesaler respectively.

30. The car rental market is subject to the typical seasonal changes in demand experienced by other participants in the tourism industry, with the peak season for leisure rentals being

November to March. Demand often exceeds supply during this period, particularly in February. Demand can also exceed supply outside of this period in popular tourist locations, such as during the ski season in Queenstown. Rentals to business travellers are typically constant over the course of a year and do not vary on a seasonal basis, with the exception of a trough over the Christmas period.

31. To cater for the change in demand, the size of rental company's vehicle fleets fluctuates from winter to summer. Rental companies that lease vehicles typically gear their leases to expire at the cessation of the summer period, whilst not adding new leased vehicles to their fleet until the following peak period, thereby de-fleeting over the winter period. Rental companies who own their own vehicles store a proportion of their vehicles over the winter period and may deregister the cars.

32. Car rental companies can be grouped into three different tiers. The first tier operates booths at international airports and has a license to sign rental clients and has vehicles on-site at these locations. For convenience the Auckland International Airport nomenclature of "Class A services" will be adopted for this group. The second tier ("Class B operators") are present at airports through free phones and bill board advertisements, and are permitted to meet clients at airports and shuttle them to an off airport site to be signed up. The third tier ("Class C" operators) does not have an airport presence and are typically operators with a small vehicle fleet of lower quality than Class A or B service providers.

33. Rental companies offer a range of vehicles to their clients, with rental operations who cater for business customers typically offering their customers new vehicles, while companies catering solely for leisure customers offer either new or used vehicles, the latter being of predominantly Japanese origin. Depending on the business model of the rental company, vehicles that are leased are normally retained for a period of [ ] months. Larger operators retain vehicles that they own for a period of up to [ ] years, and potentially for a longer period for smaller operators. Vehicles range from compact models to large sedans, vans, 4WD vehicles, luxury vehicles, mini-buses and trucks.

34. Rental companies operate in the New Zealand market by one of three means:

- Corporate locations - which are owned, operated and staffed by a rental company; or

- Agencies – which use a rental company's vehicles, but which are staffed and managed by the agent; or

- Franchised operations – which have their own fleet of vehicles and run their own business under a rental company's brand, and pay a license fee to the rental company.

35. Rental vehicle reservations are made in a number of ways, including through national call centres, in person at outlets, over the Internet, by travel agencies using a Global Distribution System (GDS) and by written order. The use of the Internet to place bookings has increased and is forecast to continue to do so. The Internet is also a means by which consumers can easily make price comparisons.

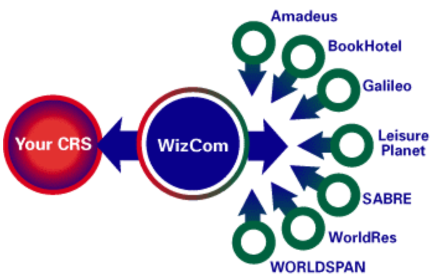
The Galileo System of Travel Distribution

36. Cendant also operates Galileo and Wizcom. Galileo's principal activity is the operation of an electronic Global Distribution System (**GDS**). Galileo's GDS provides travel agents, customers who use travel internet sites and self-booking corporations with access to schedule and fare information and the ability to make reservations and issue tickets for airlines, rental vehicles, hotels and other travel related services (e.g. travel insurance, event tickets, packages etc.)

37. Galileo also offers IT services (such as quotation services) to airlines, and operates travel agency web portals. The travel agency web portals allow Galileo's travel agent customers to create their own internet sites, thus providing them with an additional point of presence on the internet that may contain links to other travel related internet sites.

38. Galileo distributes rate and availability information and processes bookings for Budget New Zealand, as it does for other vehicle rental companies in New Zealand, including Avis, Hertz and National.

39. Cendant, through WizCom and other entities of the group, provides switch services, i.e., an electronic interface between the various GDS operators and the internal computer reservation systems (**CRS**) of travel suppliers such as hotels and rentals vehicle providers. The switch interface allows such suppliers to make their inventory available on multiple GDSs without having to connect directly and separately to each GDS by 'publishing' the supplier's inventory in a format that the GDSs, and other corporate/internet direct channels, can interpret and display. The role of WizCom is outlined in the picture below:



40. Cendant, in part through WizCom, also provides CRS services to hotels and car rental companies.

Marketing of Rental Vehicles

Leisure Customers

41. Leisure customers usually rent vehicles by one of two means:

- From a travel agent who purchases from a travel wholesaler; or
- Directly from a car rental company.

42. Travel Wholesalers typically offer customers a range of car rental companies to choose from, differentiated by both price and quality. Travel wholesalers have contractual

arrangements with car rental companies that guarantee the wholesaler a certain number of car rental days annually.

43. Rental cars rented to leisure customers are marketed in the same manner as other tourism and transport products. Depending on the particular operator, a proportion of sales are pre-purchased by tour wholesalers, and sold through the retail travel industry overseas. The proportion of leisure customers who rent cars in this manner is estimated to be around [ ] of total leisure travellers. The remainder of sales to leisure customers are made to tourists upon arrival in New Zealand, with a small proportion of around [ ] of hires made by domestic leisure customers. A small but growing proportion of hires is also made via the Internet.

44. Travel wholesalers normally require a mix of rental car companies in their brochures to present their clients with a range of rental options. However, this mix is limited to rental operators who operate on a scale large enough to provide a sufficient national network of retail outlets and range of vehicle choices. Gulliver advised the Commission that it will [ ]. However other travel wholesalers include a broader range of companies, including medium sized car rental companies with a national network of locations.

45. Rental companies also market through direct marketing at airports and tourist accommodation, and through the media.

Business Customers

46. Business customers usually rent vehicles by one of three means:

- Through a pre-negotiated contract with a car rental company;
- Through a corporate travel agent; or
- Directly from a car rental company.

47. A pre-negotiated contract, referred to as a "preferred" arrangement with a car rental company is the result of a tender process through which a business negotiates a car rental supply contract with a car rental company.

48. Rental cars are marketed to business customers on a retail basis in the same manner as to leisure customers. However, business customers differ from leisure customers by establishing direct contractual relationships with car rental companies for the hire of rental cars. This relationship is established by a tender process, during which car rental companies bid for the right to be the preferred provider of car rental services to businesses. The criteria used by companies to assess a tender include price, quality, service, a national network and the airport presence of a car rental company.

MARKET DEFINITION

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

> *. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

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

51. The Commission seeks to define relevant markets in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);
- the level in the production or distribution chain (the functional level);
- the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
- the temporal dimension of the market, if relevant (the timeframe).

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

Views of the Market

Cendant

53. Cendant has proposed a market definition of the hire of all cars, including (at least) up to 8-seater vans on the basis of demand and supply-side substitution. Cendant proposed a national geographic market in that a large number of suppliers competed on a national basis, that suppliers engaged in national advertising and promotional activities, a large number of suppliers allow for one-way rental services (customers may collect a vehicle in one location and return it in another) and that competitors with a primary focus on discrete geographic locations constrain the prices of national rental car operators.

54. Cendant also noted the Commission's decision in regard to *Tourism Holdings/Britz* concerning motor home rentals:

> "THL and Britz operate nationally, as do other motorhome rental operators. A national operation allows the customer to collect the motorhome at one location (such as the point of entry into New Zealand), and drop off the vehicle at a different location (such as the airport of departure). The Commission understands that this is standard practice within the motorhome Motor Vehicle Rental Market."

"Given the national coverage available to consumers, the Commission considers that the geographic market is a national one."

55. Cendant divided its business into three segments:

- Corporate/government contracts;
- Travel wholesaler contracts; and
- Domestic/international leisure.

56. Cendant argued that the national geographic market included both on (inside) and off (outside) airport locations. Cendant discussed the ACCC determination, *Hertz, Avis, Thrifty and Budget*[3] which noted that off airport operators exist and people are prepared to leave the airport before obtaining a rental car. Cendant acknowledged that the High Court in the *ARA*[4] case found a market for rental cars at Auckland Airport. Cendant argued that though such a market definition may arguably be appropriate in a restrictive trade practices case, it was not likely to be warranted in a merger context.

57. In response to the Commission's proposed definition of a market for business and a market for leisure car rentals, Cendant submitted that corporate customers frequently "flipped" from corporate to leisure rates and therefore that the market for corporate customers is linked to the market for leisure car rentals. Cendant provided evidence to indicate that [ ] of their leisure segment business in terms of rental car days, were in fact corporate customers who elected to rent a car at the leisure rate. Cendant stated that the average daily rates (excluding additional charges such as insurance) is [ ] for corporate customers and [ ] for leisure customers and [ ] for inbound customers.

58. CRA acting as advisors for Cendant argued that as the rights to have a booth at airports were allocated by an auction mechanism, the additional price that on-site rental operators could charge would be transferred to the airports and this cost included in the costs of rental car provider. Provided the auction is competitive and the bidders have symmetric cost structures the maximum price differential between on-site and off-site rental car suppliers would be captured by the airports. Therefore any attempt by on-site providers to raise prices would result in substitution to off-site providers to sufficient extent to constrain the price increase.

Hertz

59. Hertz proposed a market for rental car services for business customers and a market for leisure customers. Business customers consisted of corporate and government customers of rental car operators. Hertz argued that for business customers, the geographical dimension is incorporated within the product dimension of the market. The convenience of an airport booth to business customers is a consequence of the geographical proximity of booths to disembarkation points at airports. This convenience of service is paramount to the product dimension and is the defining parameter for business customers. Hertz proposed that for business customers the geographical boundary of the market should be

[3] Authorisation Number A90687, 25 August 1999, Hertz, Avis, Thrifty and Budget
[4] *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* (1987) 2 TCLR 141

confined to geographical areas around booths at airports. Hertz argued that a high proportion of business rental car custom is transacted through booths within airports. Suppliers without booths at airports are unable to deliver the required service on a timely basis or provide the face-to-face service that business customers require. Hertz noted that business customers rent vehicles for shorter periods of time than leisure customers and that leisure customers are likely to be less time conscious than business customers and therefore be willing to travel offsite for a better deal.

60. In response to a Commission request for information on "flipping", Hertz stated that they did not consider flipping to be significant and did not measure the extent of flipping. They stated that average yields on corporate rentals were [ ] whereas leisure customers were [ ]. Hertz noted that the corporate rate is generally better (with rare exceptions) than the leisure rate and that customers had no incentive to flip.

Product Dimension

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

62. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[5] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the *ssnip* test to determine market boundaries. The Commission takes into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

The nature of the product

63. Rental car operators provide motor vehicles for short-term rentals for business and leisure customers. The size of the vehicles range from small cars to 8 seater people movers, 11 seater vans and trucks. Rental car operators differ in the geographical coverage, on/off airport service, age of vehicle and size of fleet. Short-term has not been defined by the applicants, however information provided on the duration of rental cars suggest business customer rent cars on average for 2 to 3 days, while leisure customers rent cars on average for 6 to 8 days.

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[5] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission said: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

Commission's previous view of the market

64. The Commission has not previously considered a market or markets for rental cars. However in Decision 365 *Tourism Holdings/Britz*, the Commission defined a national market for motorhome motor vehicle rentals.

The Commission's view of the appropriate market

65. The Commission notes that Cendant Corporation proposed a separate markets for corporate and leisure car rentals in its proposal for clearance from the European Commission to acquire Galileo. The European Commission accepted these market definitions in its clearance of the merger.

66. Business customers have a number of characteristics that distinguish their demand from leisure customers. Business customers generally hire rental cars on the basis of one to three year contracts with particular rental car companies. These contracts generally require that a provider of rental car services has:

- on-site booths at the major airports (Auckland, Wellington, Christchurch);
- a national network of offices at regional airports and centres;
- a new vehicle fleet; and
- a substantial fleet size to ensure availability of cars.

67. Business customers require the convenience of on-site airport locations both for minimising the time required to collect a car and for the flexibility offered by an on-site presence to make new arrangements when flights are delayed or business arrangements change. Furthermore as Hertz argued, business customers rent vehicles for a shorter term and are likely to place a higher value on time than leisure customers and therefore not regard off-site airport rental car providers as a reasonable substitute for on-airport providers. Major business customers provided evidence to the Commission that on-site airport booths were a minimum tender requirement for contracts with rental car providers, or that airport booths were used as part of a first cut criteria, i.e. the relative prices of on-airport and off-airport suppliers were not considered against each other. This evidence suggests that business customers do not consider that off-airport operators are satisfactory substitutes for on-airport rental car suppliers.

68. Business customers generally require a national network of offices to provide service in various parts of the country. While it may be possible for business users to reach separate agreements with rental car providers in different parts of New Zealand, in practice business customers generally make arrangements with one supplier. Making arrangements with one supplier minimises the transaction cost of contracting and on-going interaction and ensures standardised service across the country.

69. Businesses generally require fleets based on new car purchases. This requirement is based on the perceived safety and reliability of new cars as compared with second-hand cars. In certain times of the year, such as February, when both leisure and business demand is high, it can be difficult to find a rental car available. Business customers are concerned with fleet availability, i.e. when they arrange a car, that the required vehicle

will be available at the required location. Non-availability of cars requires customers to make arrangements with a second firm, and they will not then benefit from any buying discount they may have based on the size of their business. A large vehicle fleet increases the likelihood that vehicles will be available.

70. These factors and their interaction with each other result in business customers having different demand characteristics from leisure customers. A provider who cannot meet these characteristics will not be able to compete for most business customers, although they may be able to supply some business customers at the fringe, such as a business customers who only have a demand for service in a particular region, or as a back-up supplier to a major car rental provider.

71. The evidence of behaviour by business customers confirms this view with major rental car suppliers Avis, Budget and Hertz, who fit these criteria supplying 85 to 90% of business customers. Business customers switch between Avis, Budget and Hertz, but rarely switch to alternative suppliers. The different demand characteristics mean that a hypothetical monopoly supplier with a national network, on-site location at major airports, and a large new vehicle fleet would be able to raise prices 5-10% above competitive levels without sufficient demand-side substitution to render the price increase unprofitable.

72. The Commission does not consider the evidence presented by Avis of corporate customers "flipping" to leisure rates is sufficient to suggest that business and leisure customers are one market. Information provided by other business rental car suppliers such as Hertz, Thrifty and National did not support Cendant's contention that "flipping" is commonplace. The Commission also discussed "flipping" with business customers and business travel agents, none of whom were aware of "flipping" and were of the view that such behaviour was unlikely given the difference in business and leisure rates. On the evidence supplied by Hertz there are significant price differences between corporate and leisure rates. While the evidence from Avis does not support leisure rates being more expensive than business rates, this evidence appears to be inconsistent with earlier information supplied by Avis on discounts for corporate customers and the views of corporate customers, corporate travel agents and other rental car suppliers. Therefore, the Commission considers that it is likely that corporate rates are significantly less than leisure rates. In this case, the ability to "flip" to leisure rates may be insufficient to constrain business rates. The Commission does not consider the evidence on "flipping" to be sufficient to justify defining a single market for car rental, however, the Commission does consider that it is appropriate to take into account "flipping" in the analysis of competition.

73. The Commission considers that the CRA argument that competitive airport slot auctions will ensure that car rental charges already incorporate all rents from on-site location is not likely to hold. Firstly, it appears that the airports have a preference for Avis, Budget and Hertz to have slots, from the conduct of the [ ] airport slot tender and because slots are charged on the basis of a percentage of turnover, which results in the airports preferring a rental car supplier with an international network and brand. Secondly, for some airport tenders there are the same number of bidders as there are slots, which suggests that the airports will not be able to extract all of the rent associated with airport slots. Thirdly, it is possible that the merger of Avis and Budget may change the balance of bargaining power between the airports and the airport slot bidders. Finally, corporate

customers have suggested that they would prefer to pay higher prices than substitute to off-site rental car suppliers.

74. Demand-side characteristics are not themselves sufficient to conclude that business customers are in a separate market. On the supply-side, the Commission has considered whether other suppliers could move into the business market, even though they do not presently supply this market. A key impediment for a leisure car rental firm to supply the business market is the need to obtain a booth at the three major airports. Slots at these airports are limited to four rental car providers at all three airports. Avis, Budget and Hertz have slots at all three airports. National has a booth at the Auckland domestic terminal and Thrifty has a booth at Wellington and Christchurch airports. Airport slots are currently tendered on a five yearly basis. The next tender at Christchurch airport is 2003, at Wellington is 2004 and Auckland is 2006. Therefore, for a firm outside of the current holders of slots to enter the market in all three locations would take five years. This time period is well outside the 12-month period generally considered for a SSNIP test. Therefore, it is not possible for existing leisure only rental suppliers to move into the corporate market within a reasonable timeframe. Thrifty and National are fringe participants in the business market as both have slots at some but not all major airports, and smaller networks than Hertz, Avis and Budget. The Commission acknowledges in the following competition analysis that there may be some realignment of fringe participants that makes entry possible inside of a two-year period. However, the Commission does not consider this is likely within the 12-month period generally considered for a SSNIP test.

75. There may be other impediments to moving into the business market, which reinforce that arising from limited airport slots. To compete in the business market, a firm requires a national network of offices and a large vehicle fleet. Some level of advertising and marketing spending may be required to build and maintain brand awareness. These factors may require firms to have a substantial amount of capital and be prepared to commit to a level of sunk costs. However, the Commission does not consider that these factors would in themselves be significant impediments. A rental car provider can reduce the level of sunk costs in establishing a national network by using franchisees or agencies to provide service at some locations. The vehicle fleet may be leased, which reduces the level of upfront capital required to establish a fleet. Furthermore a number of operators in the leisure market have large fleets [ ], although not as large as Avis, Budget and Hertz [ ]. The level of marketing and advertising expenditure does not appear to be high relative to sales. Rental car providers do not currently use television advertising. Advertising expenditure on signs and brochures is at least partly scaleable with size. [ ]. These factors do not in themselves prevent car rental companies from moving into the market, although they may reinforce the difficulties arising from limited airport slots.

76. The Commission considers that both the demand- and supply-side characteristics of business customers lead to the conclusion that business customers of rental cars are a separate market.

77. There appears to be little significant product or service differentiation in the business market, with Hertz, Avis and Budget offering a similar range of cars, on-site access at airports, a national network of offices and account management services to customers. Customers viewed Avis, Budget and Hertz as close substitutes to each other. There is

differentiation between these three companies and the fringe providers Thrifty and National because the latter do not have slots at all major airports.

78. Leisure customers are likely to have a more diverse range of characteristics than business customers. There is evidence that leisure customers are willing to rent cars from off-airport operators, and to rent older cars. There are a number of significant operators (apart from Hertz, Budget, Avis, National and Thrifty), with offices at a number of locations around the country, who rent cars to leisure customers. There are also many smaller regional rental car providers. Leisure customers include those booked through travel wholesaler, and domestic/international customers booked via travel agents or directly by the customer. Travel wholesalers generally market a range of rental car providers and do not require the same minimum criteria as business customers. In-bound visitors from other countries can use the service of a travel wholesaler or book themselves. The Commission does not believe that there is any reason to distinguish between travel wholesale and other leisure customers.

79. There appears to be considerable service differentiation in the leisure market, with operators offering different services on the basis of vehicle age, location of offices, ability to make one-way journeys, use of travel wholesalers, proximity to airports, size of fleets and considerable variation in price. It is possible to think of this differentiation in terms of tiers of the market. The upper tier of the market is for leisure customers with similar demand characteristics as business customers, in terms of requiring a recognised international brand, national network of offices, new cars, linkages to international reservation systems or travel wholesalers, and booths at major airports. The lower tier of providers provides services using older vehicles with a limited or no national network and without an international brand or reservation system. It may be possible to divide the lower tier into two groups, the first group provides services on a national basis and allows for one-way vehicle rental and second group of providers who only compete on a local or regional basis. In considering the impact of this merger, the Commission believes that any impact is likely to be experienced in the upper tier of the market. The Commission considers that although it may be possible to define separate leisure markets, that this is not required in order to consider the competitive impact of the merger, as any affect from the merger on the top tier of the leisure market will be experienced in the business market. Therefore, the Commission will analyse the impact of the merger on leisure customers as one market, but carefully consider the implications of conclusions on the impact of the business market in light of the differentiation in the leisure market.

80. The Commission considers that although the business market is a separate market from the perspective of business customers, it is unclear whether the leisure market is a separate market from the perspective of leisure customers. If a hypothetical monopolist of leisure car rentals raised the price of leisure car rentals by 5 to 10%, those leisure customers in the high quality segment of the market might switch to business-type car rental. On the other hand, customers at the low quality end of the market might not switch to business rental services, due to the significant price-quality gap. As a conclusion on demand-side substitutability from the leisure market to the business market is not required for the purpose of this determination, the Commission has not reached a firm view on this issue.

81. On the supply side, there do not appear to be significant impediments to business suppliers moving into the leisure market. A supplier in the business market is likely to be able to switch to the leisure market (but not vice versa, as discussed above) as the

facilities required to service business customers can also be used to serve leisure customers. On this basis, there is an asymmetry in that from the perspective of the business customer, there is a separate market for business car rentals, while from the perspective of the leisure customers, it is likely that due to supply-side substitution there is one market for leisure and business customers. The Commission considers that if a hypothetical monopolist of leisure rental cars raised its price by 5 to 10%, that a supplier of business rental cars would supply the market. In practice, suppliers of business rental cars also supply rental cars for leisure customer, while most suppliers serve the leisure market alone. In the context of the merger proposal, it is relevant to consider both the business market and the leisure market, as Avis and Budget are active in both markets.

82. Both Avis and Hertz have proposed that the rental car market (or markets) include vehicles of up to 8 seats. The Commission accepts that there is likely to be a chain of substitution in the rental market linking small cars to medium-size cars, and medium-size cars to large cars and luxury cars, and from large and luxury cars to 8 seaters. The Commission understands that the next commonly available vehicle size is 11 seaters and that they are commonly used to transport groups of people such as sports teams. Neither Avis nor Hertz have proposed that 11 seaters are in the same market as the cars up to 8 seaters. The Commission proposes to define car rental markets as vehicles up to 8 seaters for the purpose of this analysis. Avis does not rent vehicles above 8 seaters and therefore the proposed merger does not represent an aggregation in this market.

Geographic Markets

83. As discussed above, the Commission considers that airports impact on the product market definition for the business market. The Commission considers that there are not separate geographic markets at any particular airport, nor that airports collectively form a separate geographic market for the purpose of considering this merger proposal. As noted in Practice Note 4, markets are defined on a case-by-case basis. Alternative market definitions may, of course, be appropriate in other contexts. In the business market, as discussed above, competition takes place between operators to supply a customer's needs across the whole country. While booths at major airports are part of the coverage required, business customers demand the ability to obtain rental cars across the country. Competition between rental car providers takes place on a national basis. Therefore, the Commission considers that the appropriate geographical market for business customers is a national market.

84. The Commission notes that in the *ARA* case, the market was defined as a rental car market at Auckland Airport, and that in the ACCC 1999 determination on *Hertz, Avis, Thrifty and Budget,* the relevant market was considered to be that for a small geographic market of Sydney for rental cars. Both of these cases differ from the present one in that they involved competition issues at a particular airport, and they were not an attempt to assess competition in the rental car market in the context of a merger at the national level. In terms of the *ARA* decision, the Commission considers that many of the points raised in regard to distinguishing a separate market for rental cars at Auckland Airport apply to the distinction between corporate and leisure customers. In regard to the ACCC determination, the Commission notes that while substitution is possible between on and off-airport locations, the question is to what degree customers regard the off-airport rental cars has been a close substitute. The ACCC noted that customers are prepared to leave the airport to rent cars. However, the Commission has found that in New Zealand, it is

leisure customers who are willing to travel off-airport for rental car services, whereas generally business customers are not. Indeed, many businesses will not even invite rental car operators without on-airport facilities to tender for business.

85. The Commission also considers that the appropriate geographic market for the leisure market is a national market. Avis and Budget operate on a national basis as do a number of leisure rental car suppliers. In addition, a large number of suppliers of rental car services operate on a regional basis. These firms compete with national firms in their regions. Although local managers in national rental car firms have individual pricing discretion, there does not appear to be an undue impact on any particular region arising from the merger. Therefore the Commission considers it appropriate to define the market for rental cars for leisure users to be a national market.

Functional level

86. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[6] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

87. The Commission considers the relevant functional level is the supply of car rental services at the retail and wholesale level. Generally rental car hire is a retail service, however, some car rental suppliers sell to travel wholesalers who then sell car hire to travel customers.

Conclusions on market definitions

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

- national market for rental car services to business customers (referred to as the corporate market); and

- national market for rental car services to leisure customers (referred to as the leisure market).

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

COMPETITION ANALYSIS

Substantially Lessening Competition

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

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

90. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[7] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[8]

91. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[9]

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

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.[10]

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

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

and, in relation to s47:

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

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

[8] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [1993] 1 All ER 289.

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

[10] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [1987] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

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

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

The Counterfactual

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

97. The applicant submitted that it was likely Budget would remain trading in New Zealand. This view was confirmed by Budget New Zealand, which stated that it was a profitable business and as such had the ability to carry on business as usual. However, Budget did not know what the instructions from the US would be if the acquisition did not proceed. It believed it could either be sold to a party other than Cendant or closed down.

98. None of the parties interviewed is potentially interested in the acquisition of Budget. However, the Commission only interviewed car rental companies, some of their large customers and the airports. Parties not known to the Commission could become interested in buying Budget if the acquisition were not to proceed. For example, South Canterbury Limited, [ ], bought the company in 1999. It is not uncommon for global rental car brands to have different owners in different countries. For example Avis Europe and Avis USA are owned by different firms.

99. As Budget is profitable and a well-established brand in New Zealand, the Commission is of the view that it is more likely that Budget is sold than closed down.

100. In response to the Commission's proposed counterfactual, the applicant has submitted that [

].

101. However, the Commission considers that even if "new-Budget" were not as strong as "old Budget" it would still have the characteristics of a fully competitive car rental company in the corporate market. Furthermore, if the existing Budget operation were to be withdrawn, its airport slots may become available to National and Thrifty.

102. The Commission therefore proposes as the counterfactual that a party other than Cendant buys Budget.

Potential Sources of Market Power

103. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

104. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one year time frame.[11] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

105. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

106. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

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[11] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

Conclusion – Competition Analysis Principles

107. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

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

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

ANALYSIS OF EXISTING COMPETITION IN THE CORPORATE MARKET

Introduction

109. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. In this particular case, the Commission is concerned with implications for competition in the market for business rental car services from the reduction in major suppliers from three to two. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

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

111. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure, which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately

conservative assessment of concentration, and that the factors, which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[12]

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

Existing Participants

113. There are three major car rental companies competing in the corporate market: Avis, Budget and Hertz, which all have a large share of the corporate market. Corporate rentals represent about [ ] of their revenues [ ]. Their corporate client base consists of large corporate clients whose contracts are worth more than [ ] and medium to small corporate clients whose contracts range from a [ ]. The small to medium contracts would represent up to [ ] of the revenues from corporate clients of each of Avis, Budget and Hertz.

114. Thrifty and National compete in the corporate market to a lesser degree. Their corporate client base generally would only consist of medium to small corporates whose contacts are worth less than [ ] a year.

115. Alongside the five main New Zealand car rental companies, a few smaller companies such as Apex participate in the corporate market on an adhoc basis.

Safe Harbours

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

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

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

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

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

Market Shares

118. The applicant used the average number of cars registered with the Land Transport Safety Authority to estimate the market shares of each participant.

119. However, fleet numbers vary throughout the year as most of the companies halve their fleet in winter. Furthermore, it is difficult to estimate within the fleet which cars are used by corporates and which cars are used for leisure purposes. The Commission therefore proposes to use the revenues as its primary measure of market share and concentration. The resulting shares are shown in Table 1.

Table1: Estimate of the Market Shares for the Corporate Market

Operator	**Revenue ($M)**		**Market shares (% of revenue)**	
	As stated by participants	**With Hertz's estimates for Budget and Avis**	**As stated by participants**	**With Hertz's estimates for Budget and Avis**
Avis Budget	[ ] [ ]	[ ] [ ]	[ ] [ ]	[ ] [ ]
Merged Entity	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Hertz Thrifty National Other Operators	[ ] [ ] [ ] [ ]	[ ] [ ] [ ] [ ]	[ ] [ ] [ ] [ ]	[ ] [ ] [ ] [ ]
Total Market	**[ ]**	**[ ]**	**100**	**100**

120. Table 1 gives two different estimates of the market shares:

- The market shares calculated with the figures provided by each participant; and
- The market shares calculated with Hertz's estimates of Budget and Avis' revenues for the corporate market.

121. Given Avis and Budget's fleet size and their share of airport revenues, the Commission is of the view that the market shares they provided might be underestimated, possibly because of the fact that it can be hard to draw the line between leisure customers and corporate customers.

122. As Hertz's figures are only estimates of Budget and Avis revenues and might be over estimated, the Commission proposes to use the above figures to define a range where the market shares are likely to be. For example, Avis would have between [ ] and [ ] of the market shares and the merged entity between [ ] and [ ] of the market shares.

123. Should the acquisition proceed, the merged entity would have between [ ] and [ ] of the market shares in the corporate market with a three firm concentration ratio of [ ] to [ ]. Whatever the estimates, these figures fall outside the safe harbours.

124. As already noted, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

State of Existing Competition

125. Corporate customers require their preferred suppliers to have the following attributes:

- National coverage so that they can have a car wherever they want;
- A large fleet, so that there are always cars available when they need one;
- New vehicles for safety standards reasons as the rental cars will be used by their staff;
- Booths within the airports for convenience and timely pick-up;
- Innovative account management with the ability to offer pricing solutions adapted to their needs; and
- The ability to provide an efficient single transaction management system for all the rentals throughout New Zealand.

126. Below is the analysis of Avis and Budget's competitors' ability to cater for all those requirements and represent a constraint to the merged entity should it increase its prices post acquisition.

Hertz

127. Most of the large corporates considered that Avis, Budget and Hertz were offering very similar products in terms of pricing solutions and services.

128. Like Avis and Budget, Hertz is able to satisfy all of the corporates requirements:

  - It has a very extensive national coverage encompassing not only the main centres but also more remote areas such as Whakatane or Hokitika. Furthermore, it is able to offer competitive rates for pick-ups and drop-offs in remote areas where it does not have any offices;
  - It has a large fleet of between [ ] (in winter) and [ ] (in summer) of new cars that it leases for an average of [ ];
  - It has booths within each of the main airports and particularly the three major ones: Auckland, Christchurch and Wellington;
  - It has a single transaction management system for all rentals in New Zealand and efficient and innovative account management; and
  - It has a recognised and reputed brand.

129. Furthermore, Hertz would always be amongst the tenderers for large corporate contracts. Where tenders are run on a closed basis, Hertz would always be invited alongside with Avis and Budget to bid for rates and services.

130. Hertz's ability to compete against Avis and Budget is substantiated by the fact that both Budget and Avis lost large customers to Hertz within the last five years.

131. The Commission considers that Hertz is currently an effective competitor to Avis and Budget. However, the Commission has to ascertain that it will remain so in the future.

132. Cendant and Budget submitted that:

> *"*The constraining presence of Hertz in a Large Corporates Market would remain post-acquisition. Hertz is a significant competitor. It is the largest car rental firm in the world, has substantial infrastructure and has existing relationships with a significant number of Large Corporates.
>
> The substantial and enduring constraint imposed by Hertz is also illustrated by reference to its:
>
> (a) Nation-wide spread of locations, including its presence at all major airports;
>
> (b) Brand strength;
>
> (c) Significant international links with airlines, including membership in a range of frequent flyer programmes; and
>
> (d) High standard of fleet and outlet presentation.
>
> [ ]% share of a Large Corporates Market. The volume of business represented by such accounts provides a powerful incentive for Hertz to compete aggressively for Large Corporate accounts whenever they become available."]

133. The Commission has considered the applicant's submission from two perspectives. Firstly, Hertz's ability to remain an effective competitor and constraint to Avis and Budget will be considered. Hertz's ability to constrain the pricing of merged entity post-merger depends on whether or not Hertz will face any barriers to expansion post-acquisition, i.e. whether or not it would be able to service the merged entity's customers, should they switch to Hertz as a result of an increase in price by the merged entity.

134. Secondly, the impact of the merger on the behaviour of the merged entity is considered. Under the substantial lessening of competition threshold, the focus of the competition analysis must take into account any oligopoly structure of the market in question. In such markets, economic theory suggests that even where firms do not coordinate their behaviour, but instead seek independently to maximise their profits, it is possible for unilateral market power to emerge. In addition, a merger in such a market, which in the present case would result in a reduction in the number of major firms from three to two, may result in an increase in that market power.

Assessment of Hertz ability to expand in the market post merger

135. As explained above, Hertz already has a nationwide network of locations, a reputable brand and a single management system. Hertz's ability to expand in the corporate market post-acquisition will depend on whether it is able to increase the size of its fleet and the capacity of its depots at the airports.

Fleet size

136. Hertz submitted that a constraint on expansion in the market would be the limit on fleet sizes from restrictions in fleet leases and from manufacturers on fleet numbers.

137. However, as discussed below in the section on barriers to expansion, the Commission has found that the restrictions imposed by car manufacturers or fleet lease agents on the number of cars they make available to car rental companies do not represent a barrier to expansion or entry. The reasons are:

- There are enough car leasing companies and manufacturers to get cars from in the event one of them were to limit the number of cars and prevent fleet size expansion;
- Car rental companies do not have any exclusive supplier agreements with car leasing companies and manufacturers and lease cars of different brands;
- The total pool of cars required by all the car rental companies for the corporate market would not change significantly only the share of each firm would change, should the merged entity increase prices. As the merged entity would decrease the size of its fleet in response to the reduction in demand.
- Large corporate contracts are awarded throughout the year and switching would occur on an incremental basis, which would allow car rental companies to secure the additional fleet required gradually;
- Large corporate contracts are tendered several months before they are due to start. The lead-time allows the successful car rental company to place orders and get the cars; and
- Lead-time for an order of one hundred cars would take no longer than 3 months.

138. The Commission therefore considers that Hertz would be able to increase the size of its fleet in a timely manner should the merged entity raise its prices and its customers switch to Hertz.

Availability of space at the airports.

139. Hertz submitted that expansion at airports could be restricted because of property restrictions, as purchasing additional land for use as lots is considered likely to prove uneconomic. The prime land for these purposes is, to a large extent, already occupied.

140. However, as explained below in the section on barriers to expansion, the Commission has not found evidence that there would be any restrictions put on property or purchase of land. The allocation of ready bays is reviewed and adapted by Christchurch and Auckland airports on the basis of the revenues made by each of the car rental companies with booths, every 6 months for the former and every year for the latter. If Hertz's revenues

grew as a result of a switching by customers from the merged entity, it would be allocated more ready bays.

Differentiated Product Markets

141. In differentiated products markets, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

142. With differentiated products, competition can be localised between firms producing immediately adjacent substitutes. The acquisition by a firm of its adjacent competitor may cause localised price rises (rather than price rises across 'the market') post-acquisition, because of the loss of the localised competition between the two products in circumstances where more distant substitutes fail to provide much of a competitive constraint. This effect is likely to be most marked when a business acquisition results in the two closest (and perhaps most popular) substitutes being merged. In addition, rivals may also be able to raise their prices in the changed competitive environment brought about by the acquisition.

143. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. They may be able to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. Moreover, it may be possible for new products to be added through new entry.

144. The Commission will consider both demand-side and supply-side factors, and the overall impact of the potential loss of competition, in assessing whether competition is likely to be substantially lessened.

Use of Modelling in Predicting Possible Unilateral Market Power

145. In Decision 448 the Commission made use of a Bertrand oligopoly model to gauge the possible price effects resulting from the strengthening of unilateral market power in that case. The model was devised by Shapiro[13]. The model is explained at paragraph 134 of Decision 448 as follows:

> "Broadly, the model predicts that product differentiation allows firms to exert market power, and that mergers between significant firms are likely to allow the merged entity (and to a lesser extent other firms) to raise prices. The essential reason why this model predicts that market power may be enhanced by a merger in a differentiated products market is the loss of the competition between the merging brands. Suppose firm A acquires firm B. Previously, it may have been unprofitable for firm A to increase its prices because it would have lost too many customers, some of whom would have switched to firm B. Following the merger, the same price increase will see fewer customers lost, since those switching to B will now be internalised within

[13] Carl Shapiro, "Mergers with Differentiated Products", *Antitrust Law Journal*, spring 1996, pp. 23-30.

the merged entity. A price increase that was unprofitable before the merger may become profitable after."

146. Since Decision 448 the Commission has further developed its analytical capabilities in respect of cases involving differentiated goods. Diversion ratio calculations, similar to those in Decision 448, have been incorporated into merger simulation software that generates a Bertrand-Nash equilibrium in prices for a given merger.[14] This software was developed according to specifications set out in a recent paper by Epstein and Rubinfeld.[15] In the paper, they propose a technique based on Deaton and Muellbauer's "Almost Ideal Demand System" (AIDS)[16] that is calibrated by market shares. Hence it carries the moniker, Proportionality Calibrated AIDS or PCAIDS.

147. The PCAIDS model incorporates similar assumptions to those in Decision 448. In particular, it assumes that current market shares come about because of the specific product positioning by brands in the market, and that these brands will not be repositioned in any pertinent spectrum of product characteristic after the merger. Also, it also assumes an absence of entry in response to any post-merger price increases.

148. It is noted that products are differentiated because consumers *perceive* differences in the products. Included are instances where two products may be physically identical, and yet significant numbers of consumers are prepared to pay more for one than for the other.[17] This scenario can arise where products are strongly branded, possibly through advertising, and consumers form preferences for one product over another, perhaps for intangible product characteristics such as image or reputation. Another product characteristic that can be varied, and hence can cause differentiation, is the geographical location of outlets.

149. The Commission considers that the corporate rental car market can be characterised as being differentiated to some degree, by at least the above mentioned factors being strong branding and the physical presence (or lack of same) of front-of-house facilities (booths) at airports i.e. their geographical breadth of coverage.

150. The model requires as inputs the following:

- market shares (as measured by revenue);
- the market price elasticity of demand; and
- the own-price elasticity of demand of one of the brands in the market.

A further option is to include estimates of post-merger efficiency gains by the merging parties.

151. The calibration of the model in this case proceeded as follows. As discussed elsewhere the market demand can reasonably be regarded as being relatively price

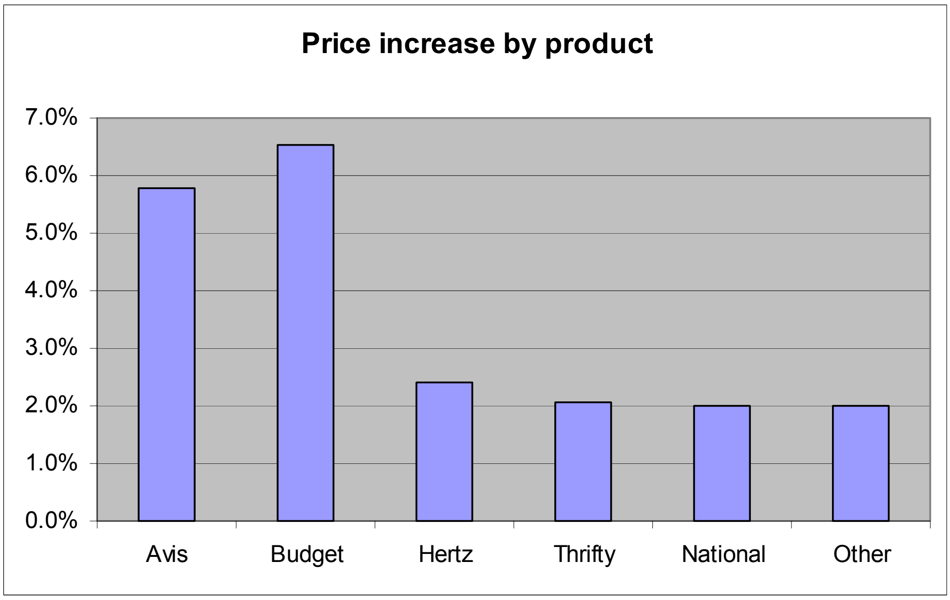
[14] For a full exposition see Jean Tirole, *The Theory of Industrial Organization*, Harper Collins, 1988, chapter 7.
[15] Roy Epstein and Daniel Rubinfeld, "Merger Simulation: A Simplified Approach With New Applications", *Antitrust Law Journal*, vol. 69, pp. 883-919.
[16] Angus Deaton and John Muellbauer, "An Almost Ideal Demand System", *American Economic Review*, June 1980, pp. 312-26.
[17] See D. W. Carlton and J. M Perloff, *Modern Industrial Organization* (2nd edition), 1994, p 283.

inelastic. Accordingly, given the absence of empirical evidence, a market elasticity of -0.7 was assumed.

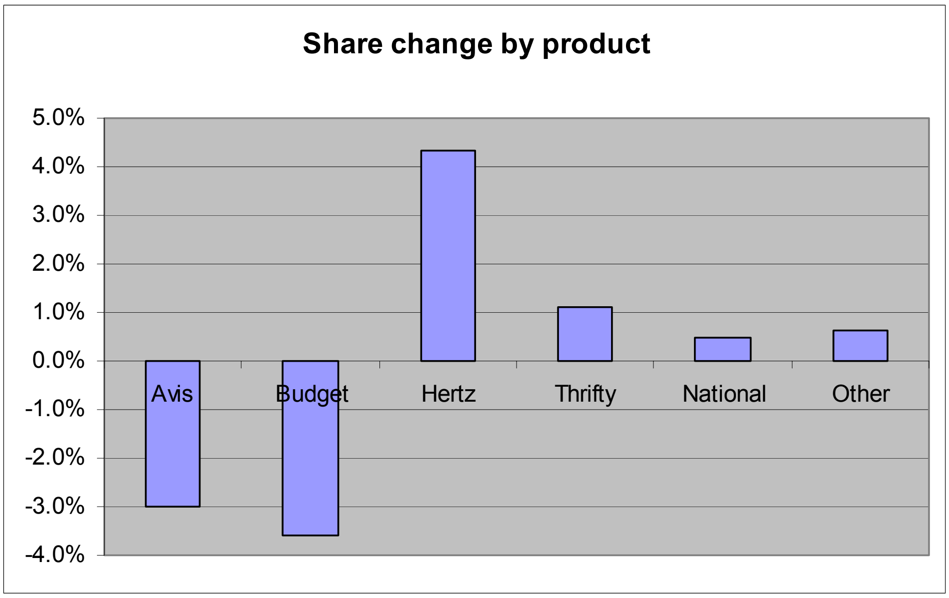
152. Own-price elasticity can, in this context, be regarded as a measure of the degree of product differentiation between competing brands. If products are relatively highly differentiated then the market power of each brand is relatively high, and price response as measured by the own price elasticity is relatively small in absolute terms (ignoring the negative sign). Estimates of own-price elasticities are not available for rental car service brands, but in differentiated product markets such elasticities seem typically to be in the range of -2 to –6. The Commission's view is that the corporate market is differentiated, but not to a high degree. Customers appear generally to regard the brands of the three larger firms as being reasonably close substitutes. However, given the uncertainty, a conservative range of own-price elasticities for Avis of -4, -6 and -8 was used.

153. Cendant's economic consultants, Charles River Associates (CRA), made a submission regarding the use of the model. In it they submitted that more elastic own-price elasticities should be used. Their argument was based on the use of accounting data to estimate price-cost margins, from which they inferred Avis's own price elasticity. The Commission found this debate helpful, but considers that the estimated price-cost margin (and hence the derived elasticity) was highly sensitive to certain assumptions made by CRA. Furthermore, the Commission considered that it was inappropriate to include [ ] as an element in the calculation of marginal cost. The Commission formed the view that the own-price elasticity is most likely to lie within the -4 to -8 range.

154. Results of simulation runs with the above inputs and assumptions suggested that the proposed merger might result in a weighted average price increase of between 3% and 6.5%. The following graph shows post-merger price increases by brand for an Avis own-price elasticity of -6.



155. In addition to price changes, the model also calculates changes in shares that might result from the predicted price changes. The following graph shows these changes for an Avis own price elasticity of -6.



156. As already noted, one of the assumptions of the model is that other car rental firms will not reposition their brands post-merger in such ways as to compete more strongly with the merged entity, and hence impose a more effective competitive constraint. However, the market [

].

157. Charles River also presented an argument that the nature of price-setting in this particular market might undermine a basic assumption of the model, and hence render its use invalid for this case. The argument was that a bidding model would best describe the price-setting behaviour, as car rental firms typically acquire business by tendering for the business of large corporates. Firms do not set a price common to all customers, as assumed in the basic Bertrand model, but rather tailor bids for each customer. The Commission acknowledges that much of the price-setting behaviour in this market does seem to have the character of bidding competition but points out that the alternative model proffered by CRA seems to assume that brands are undifferentiated, which is contrary to a basic feature observed in the market. The upshot of such an approach is that pricing will be at marginal cost, which is the same result as occurs under Bertrand pricing in the absence of differentiation.

158. The use of merger simulation in the Commission's deliberations is still under development. In this instance the model was useful for its ability to focus the parties attention on key assumptions regarding characteristics of the market. The Commission anticipates that its value will be in its ability not to produce 'proof' of a substantial lessening of competition, nor to supplant the Commission's exercise of judgement, but rather in providing support to the Commission's deliberations by:

- focusing parties' attentions on verifiable economic arguments;
- making transparent the values of the key parameters and assumptions in the Commission's analysis; and

- producing quantitative estimates of the results of a given transaction.

Conclusion on Differentiated Product Markets

159. The Commission considers that the potential unilateral market power arising from the differentiated nature of rental car services appears to suggest that there may be a matter of concern post merger, a view that the modelling seems to support. The results of the model are, however, dependent on the fringe participants continuing to provide little constraint on the behaviour of the major suppliers. Before reaching a conclusion on the potential for the exercise of unilateral market power it is necessary to consider the effect the fringe participants would have on market dynamics. The potential of fringe suppliers to constrain post merger behaviour by expansion and re-positioning is discussed below.

Thrifty and National

160. Thrifty and National would be able to satisfy most of the corporates' requirements listed above, but to a lesser extent than Budget, Avis and Hertz.

161. Both have new cars that they lease for an average of [ ] months and a reasonably sized fleet. However, with fewer than [ ] cars each, their fleets are not as big as Budget, Hertz and Avis', which increases the risk for corporates of not having a car available, particularly in summer when demand exceeds supply.

162. Their national coverage is not as extensive as that offered by Hertz, Avis and Budget. For example, they would be absent from remote locations such as Hokitika, Greymouth, Gisborne, Whakatane, Kerikeri and Kaitaia. This translates into surcharges for customers to get a car delivered in those remote areas, reflecting the additional cost of providing this service.

163. The Commission also understands that National and Thrifty would not be able to provide the same level of technological sophistication for booking as the three main players. Thrifty mentioned that its customers had more simple needs and for example would not require an integrated reservation system.

164. Furthermore, neither Thrifty nor National is present at all of the three main airport terminals:

- Thrifty has a booth at the Christchurch domestic terminal and at Wellington airport, but none at Auckland airport where it is only allowed to pick up and drop off customers under its license B contract.

- National has a booth at the Auckland domestic terminal, but is only allowed to pick up and drop off customers at the Auckland international terminal and Wellington and Christchurch airports.

165. Both of them said that not having a booth in each of the three main airports was preventing them from acquiring many corporate customers and increasing their market share. Most of the large corporates confirmed that they required booths at the airports.

166. [

]. Furthermore, it lacks experience with regard to setting prices for the corporate market and claims that this has resulted in it offering higher prices than Avis, Budget and Hertz in previous tenders.

167. Furthermore, Thrifty and National do not seem to be considered as effective competitors by corporates. Some of the large corporates run closed tenders with only Avis, Budget and Hertz being invited to tender for the contracts. This was the case with the [ ] and [ ] when the latter reviewed its contract with Avis. Where National and/or Thrifty are given a chance to tender, they tend to be eliminated during the first round because they do not match Avis, Hertz and Budget with respect to services, network, presence at airports and sometimes prices.

168. As Hertz pointed out in its submission, its experience is that it rarely comes up against competitors other than Avis and Budget for large contracts. This is substantiated by the fact that the only competitors Avis and Budget had lost clients to were each other and Hertz.

169. Cendant and Budget submitted that if they were to impose a SSNIP post acquisition, a significant number of large corporates would substitute to either Thrifty or National and would accept being met inside the terminal by either company at the airports in which Thrifty or National did not, at this stage, operate a counter.

170. However, as explained above, the characteristics of demand for rental car services are such that the cross-elasticity of demand between the different types of rental car services is low. It is therefore unlikely that large corporates would switch to either National or Thrifty, should a SSNIP be imposed by acquisition, as none of these would be able to satisfy their requirements in terms of spread of the network, technology, and “on airport” presence.

171. Currently National and Thrifty are not able to exert significant constraint on the existing players should the prices be increased by a SSNIP. However, the potential exists for National and Thrifty to reposition or expand their service should prices increase post merger. This possibility is discussed below in the section on the *LET* test.

<u>Smaller car rental companies</u>

172. A few other car rental companies operate in the corporate market on a more opportunistic basis. These companies get corporate clients whose preferred car rental companies cannot supply them or as a result of personal relationships. Corporate clients only represent a very small part of their business and they do not have contracts with them.

173. This is the case of ACE, which draws [ ] of its revenue from corporate clients. [ ] of its fleet consists of Japanese second hand cars. It has [ ] new cars and will get [ ] more by the beginning of summer 2002/2003. [ ]

174. ACE and the other main car rental companies operating in the leisure market stated that they were not interested in either entering or expanding in the corporate market, at least to the extent of Thrifty or National.

175. The Commission considers that smaller car rental companies are very unlikely to represent a constraint to the merged entity post acquisition.

Conclusions – Unilateral Market Power

176. Although Hertz is able to expand post-merger, in this case the Commission considers that Hertz will not provide a sufficient constraint on the merged entity's behaviour. However, the Commission considers that the merged entity will not be able to exercise unilateral market power in the corporate market post acquisition due to the potential for expansion and repositioning by fringe players in the corporate market as discussed below in the section on the *LET* test.

Scope for the Exercise of Coordinated Market Power

Introduction

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

178. Coordination can be either "tacit" or "explicit". Explicit coordination covers formal agreements, arrangements, or cartels, where parties formally come to an agreement on output or prices. Tacit coordination covers facilitating devices such as price signalling, conscious parallelism and price leadership. Tacit coordination can amount to no more than an understanding between market participants. A business acquisition that materially enhances the potential for either form of coordination is deemed to be a substantial lessening of competition.

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

180. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

181. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included. Collusion in the corporate market would most likely occur through an understanding or agreement between the major firms not to vigorously compete in the tender process for each others existing customers, rather than through a division of the market on a geographical basis or an agreement on prices.

182. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 3. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the supermarket market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse. Some of the factors listed may not be relevant to a given market.

TABLE 2: Testing the Potential for 'Collusion' in the Corporate Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes
Undifferentiated product	Largely yes, although there is evidence of differentiation based on branding and other characteristics.
New entry slow	Yes. New entry to the corporate market is difficult due to the need to acquire slots at all major airports.
Lack of fringe competitors	No, but it is not certain that they currently provide an effective constraint, however, the Commission considers that the fringe competitors are able to expand beyond their current level of operation.
Price inelastic demand curve	Yes
Industry's poor competition record	No
Presence of excess capacity	Not relevant as the capacity is easily adjusted
Presence of industry associations/fora etc	No

<u>High Seller Concentration</u>

183. A higher seller concentration facilitates collusion in a market. A higher concentration generally means that there are fewer firms whose actions need to be coordinated, and increases the certainty of the reaction by others to an action by one player. Greater parity in size increases the commonality in interest between market participants.

184. As discussed earlier, the three-firm concentration ratio will be [ ] in the corporate market. Post acquisition, the merged entity will have [ ] of the corporate market shares, its main competitor, Hertz, [ ]% and fringe competitors the remaining [ ].

185. Even though the acquisition will in essence decrease the number of competitors from three to two, the market will not be divided equally between the two remaining firms, as was the case in Decision 448[18].

186. The Commission recognises that the mere fact that the market will be going from three to two does not in itself suggest that there will be tacit or explicit collusion as a result of the acquisition. In some circumstances such a reduction in market participants may lead to an enhancement of competition (particularly if efficiency gains are realised). The applicant has submitted that efficiency gains will be realised in the form of significant back-lot and back office synergies from the amalgamation and rationalisation of support facilities, such as vehicle maintenance services and call centre administration costs. Also, the applicant expects that the acquisition will allow greater utilisation of Avis and Budget's fleet in some countries, and lead to lower fleet acquisition costs and other general and administrative savings.

187. However, the Commission also accepts that other jurisdictions have shown strong concerns where mergers have led to a reduction from three to two. For example, in the *Wattyl/Courtaulds/Taubmans/Pinchin Johnson* Application for Authorisation 17 May 1996, Australia, the ACCC stated:

> "A reduction from three large firms to two makes the emergence of cooperative behaviour almost inevitable even if the firms do not consciously seek to cooperate. …cooperative uncertainty as to a rival's reaction is reduced substantially as each firm is easily able to monitor the activities of the other. It may, however, take a period of experimentation to establish a cooperative outcome."

188. However, the ACCC went on to say that:

> "…there is not a nexus between concentration and competition. …the likelihood of cooperative behaviour depends crucially on other structural features … {particularly}…absence of strong international competition and if barriers are high."

189. The US Federal Trade Commission ("FTC") recently sought an injunction to block H J Heinz from acquiring Beech-Nut (a rival in the baby food market).[19] This would have led to effective reduction in firms from three to two; Heinz and Beech-Nut were the second and third largest firms in the market, with market shares of 17.4% and 15.4% respectively, while the market leader, Gerber, had a 65% market share. The US Court of Appeals ruled in favour of the FTC. The Court was strongly influenced by the combination of high concentration level and high barriers to entry, stating, inter alia:

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[18] Decision 448, Progressive Enterprises Limited / Woolworths NZ Limited, 14 December 2001.

[19] *FTC v H.J. Heinz Co and Milnot Holdings Corp* US 6th Circuit Court of Appeals, Trade cases 2001-1, 73,243.

> "Merger law 'rests upon the theory that, where rivals are few, firms will be able to coordinate their behaviour, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.'…Increases in concentration above certain levels are thought to raise[ ] a likelihood of 'interdependent anti-competitive conduct'"[20]
>
> and
>
> "The combination of a concentrated market and barriers to entry is a recipe for price coordination."[21]

190. The Commission is of the view that while three to two does not automatically imply tacit collusion, it does warrant careful consideration of the other factors that facilitate collusion and discipline.

Undifferentiated Product

191. An undifferentiated product makes it easier to come to agreement on prices, and avoids problems associated with variations in quality, changes over time in the nature of the product, and variations between firms in associated services. When there is a high level of differentiation it increases the complexity of the coordination needed to set a common price. When the product is standardised, and the competition is mostly on price, coordination becomes much easier.

192. As explained above, the Commission understands from the large corporate customers and the car rental companies themselves that Hertz, Avis and Budget offer similar car rental services, although there might be some minor differences in terms of car brands, location in smaller centres and reservation solutions.

193. The Commission concludes that only limited effective differentiation exists, and that it will not preclude potential for collusion.

Speed of New Entry

194. The speed of entry into the market is a factor in determining the incentives to collude. If the speed of new entry is slow, then the potential gains from colluding is high. If the speed of new entry is fast, then any profits gained from colluding will quickly be eroded by new entry.

195. The speed of entry into the corporate market by a de novo entrant or car rental companies other than National and Thrifty would be (very) slow due to barriers to entry such as access to "on airport" licenses. These barriers will be discussed further below.

Lack of Fringe Competitors

196. The existence of fringe competitors can often provide constraint against collusive behaviour of firms in the market. Fringe competitors are often a source of competition, and given their small size, have strong incentives to cheat on any collusive behaviour by the incumbents. This can disrupt attempts to raise prices.

197. Thrifty and National are two fringe competitors competing in the corporate market. Thrifty has [ ] of the market shares and National [ ].

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[20] Supra 90,110.

[21] Ibid 90,116.

198. It is unclear as to the level of any constraint they impose on the major firms. As explained below in the section on barriers to expansion, National and Thrifty have only been able to secure small corporate contracts. Their "on airport" absence from each of the Wellington, Auckland and Christchurch airports currently prevents them from securing larger contracts and growing their Large Corporate client base. Therefore they may not disrupt attempts to increase prices by the major firms.

199. However, the analysis needs to consider not just their current ability to constrain collusive behaviour, but their ability to do so in the two years after merger of Avis and Budget. Thrifty and National are both committed to actively competing in the corporate market and growing their market shares. They both stated that they had the [ ].

200. The Commission consider that Thrifty and National have the potential to expand to constrain collusive behaviour in the corporate market post-merger for reasons set out in the section on the *LET* test.

Price Inelastic Demand

201. If the market demand for a product is price inelastic (that is, demand is not very responsive to changes in price) there is greater scope for profiting from collusion.

202. The Commission is of the view that the demand for business car rental is very likely to be inelastic. Business car rental is a relatively small proportion of business costs, and the cost of substitute services such as maintaining an own-vehicle fleet or the use of taxis is likely to be much greater. Business users are likely to put a high value on time saved and therefore will be less willing to substitute more time-consuming transport alternatives than leisure rental users. Business users place considerable weight on factors besides the price, such as on-site airport service, national coverage and quality of vehicles. On the other hand, for leisure customers, rental prices are a greater and often dominant determinant of the generalised cost (apart from the traveller's own time). Therefore, demand by leisure customers is likely to be more price-elastic than that of business customers.

Industry Competition Record

203. The industry's competition record under sections 27, 29 and 30 is considered as a possible indicator of the prior willingness of the firms to engage in collusion, and suitability of conditions to do so.

204. There have been no cases taken by the Commission alleging explicit collusive behaviour between car rental companies. The industry has not previously been considered for tacit collusion, as this is not an offence under the Commerce Act 1986.

Excess Capacity

205. The presence of excess capacity in the industry may reflect output restrictions stemming from coordination already occurring in the market.

206. There is no evidence of any structural excess capacity in the provision of rental cars.

207. As mentioned above, the car rental market is subject to the typical seasonal changes in demand, with demand often exceeding supply during the summer period, leading to fluctuations in the size of rental companies vehicle fleets fluctuates from winter to summer. Rental companies operating in the corporate market lease their vehicles for an average of [ ] months. Up to half of their leasing contracts expire at the cessation of the summer period, which allows them to de fleet over winter

208. The ability of car rental companies operating in the corporate market to adjust the size of the fleet when demand is low reduces the excess capacity that might have otherwise occurred. In its application, Cendant submitted that Avis had a fleet occupation of about [ ].

209. Co-ordination would ordinarily cause industry output to shrink, leaving a surplus capacity. In this case, surplus capacity is less likely because the fleet size of a car rental company can be adjusted relatively easily.

Presence of Industry Associations/Fora

210. The presence of industry association/fora, or evidence of cooperative actions or attitudes among firms, may enhance the possibility of coordination. Regular communication between firms decreases uncertainties and improves knowledge, facilitating the potential for coordination.

211. Industry associations and fora facilitate collusion by allowing players in the market to monitor the less visible actions of other players. For example, industry players may learn of new innovations or investments by competitors. In some circumstances industry associations may contribute to a sense of friendliness or cooperation amongst players and discourage more aggressive behaviour.

212. The Commission is not aware of any forum where all car rental companies would meet. Some fora exist for the whole tourism industry, where some of the car rental companies are likely to meet.

Potential for Collusion

213. The assessment of the relevant structural and behavioural conditions in the corporate market in Table 2 suggests that, in absence of entry, the market is likely to be susceptible to collusion, after the acquisition:

- The market demand has been shown to be price inelastic in nature. Therefore, there are incentives for participants to raise prices by colluding.
- There is little service differentiation in the business market.
- The reduction in the market from three to two would enhance the prospects for collusion.
- The level of constraint currently imposed by the two fringe competitors (National and Thrifty) on the major firms is unlikely to be sufficient as their “on airport” absence from each of the Wellington, Auckland and Christchurch airports currently prevents them from securing larger contracts and growing their Large Corporate client base

214. As currently configured, the fringe players do not offer significant constraint in the market and that therefore they may not disrupt attempts to increase prices by the major firms post merger. However, the Commission considers the current fringe players have the potential to expand their operations so that it is possible for one fringe player to become a significant participant in the market within a 2 year period in the event of post merger collusive behaviour by Avis/Budget and Hertz.

Conclusion on Collusion

215. The Commission is of the view that in the absence of entry, the acquisition would be likely to enhance the potential for collusion. However, there are two fringe competitors

that could potentially serve to disrupt the collusion. Furthermore, the entry of a third player would reduce the profits that could potentially be gained from colluding.

Discipline

216. For coordination to be successful, deviations of individual firms from the collusive behaviour have to be discouraged by being detected swiftly and punished by the other firms.

217. The structural and behavioural factors that are usually considered to be conducive to 'discipline' in coordinated markets are set out in the left-hand column in Table 3. Again, the significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the supermarket market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'discipline; a high proportion of 'no' responses the reverse.

TABLE 3: Testing the Potential for "Discipline" in the Corporate Market

Factors conducive to discipline	Presence of factors in the market
High seller concentration	Yes
Sales small and frequent	No
Absence of vertical integration	Yes
Demand slow growing	Yes
Firms have similar costs	Yes
Price transparency	No

218. For coordination to be successful, deviations by individual firms from the coordinated behaviour would have to be discouraged by being detected swiftly and punished by the other parties in the market.

219. The structural and behavioural factors that are usually to be considered to be conducive to 'discipline' in coordinated markets are discussed below, as are whether these factors are likely to be enhanced by the proposed acquisition.

<u>High Seller Concentration</u>

220. As discussed above the acquisition would result in two firms competing in the corporate market, alongside two fringe competitors National and Thrifty. Monitoring of rivals' behaviour is generally easier the more concentrated the market.

221. For this merger the key question is the impact of the increase in concentration from three major suppliers for business rental car services to two major suppliers. In the case of the business market, where cars are hired on the basis of contracts via a sealed tender, the absence of a third tender may reduce the level of uncertainty about the behaviour of

[22] Lewis Evans, Neil Quigley, Frank Mathewson, and Patrick Hughes, "Threshold for the Scrutiny of Mergers and the Problem of Joint Dominance", 5 July 1999.

rivals. The results of the tender will therefore reveal the bidders' relative prices. This will enhance the ability of these firms to detect any deviation from co-ordinated prices. In the case of three tenderers, a firm will only know their price in relation to the winning bid and not the relationship of their price to the third tenderer. This is discussed below.

<u>Nature of Sales</u>

222. As noted in the Commission's guidelines, the more that sales are made in frequent, small orders, the lower the profit incentive to deviate on any particular sale, and the greater the risk of detection.

223. Some of the sales in the corporate market are large and not frequent. Some of the largest contracts are worth between [ ]. Furthermore, contract terms are variable, with [ ] being the minimum. Several large customers have an ongoing contract with their preferred supplier.

224. However, for medium to small contracts, representing more than [ ] of the corporate revenues for each of Avis, Budget and Hertz, sales are smaller.

225. Furthermore, there would be an on-going pattern of corporate tenders throughout the year. This means that a firm need not wait until a particular customer re-tenders to respond to price deviations by a rival. It can respond on the next occasion they compete for business. This could potentially decrease the potential gain from collusion as compared to an environment with only one-off large sales.

226. However, the variation in the size of the contracts and their term may make successful co-ordination difficult to sustain. Avis has presented evidence to suggest that at present, large contracts tend to result in price reductions, which then become the benchmark for smaller contracts. This may mean that co-ordination may not be sustained if the car rental companies consider it worthwhile to cheat to obtain a particularly large contract. A further factor is that buyers can choose to adjust the length of the contract to encourage car rental companies to cheat to win on a particular contract. At present, although many contracts are on a [ ], they are frequently rolled over. Business users may offer longer contracts such as [ ] contracts or a right of renewal to provide car rental companies with an incentive to cheat.

227. The Commission concludes that the profit incentives that could arise from deviating on a large contract are high. Although in a market with two major suppliers, deviations from a co-ordinated price will be revealed, it is unclear whether this will be sufficient to prevent suppliers from cheating on particularly large contracts.

<u>Vertical Integration</u>

228. Practice Note 4 notes that where firms in a market are vertically integrated, deviations can be concealed by a firm selling to its downstream operation at a reduced price.

229. Avis is vertically integrated with Galileo, a global distribution system. However, only a very small amount of sales is made through Galileo. There is no vertical integration between suppliers and downstream users in the business rental market.

230. The Commission is of the view that there is no relevant vertical integration.

<u>Growth in Demand</u>

231. Collusion is easier to police when demand is growing slowly, such as is often the case in mature markets, where a market share gain by a deviating firm is likely to translate directly into market share losses for other firms.

232. The demand in the corporate market is growing at an estimate rate of [ ] and is not subject to significant fluctuations in the rate of growth.

233. The Commission is of the view that the market can be characterised as growing slowly and therefore provides the transparency to permit the discipline necessary for price coordination.

Cost Similarities

234. Deviations are easier to detect when firms cannot conceal price cuts by claiming reduced costs.

235. Currently, Budget, Hertz and Avis are likely to have a similar cost structure: they all have a widespread national network of locations, booths at each of the main airports, similar fleets in terms of size, age and quality and the same level of technology sophistication.

236. If the merger were to proceed, the merged entity would have a fleet at least [ ] as big as the fleet of its main competitor, and it is likely that it would benefit from the rationalisation of its back office and will gain some buying power. However, Avis/Budget have argued that the merger will not result in the realisation of significant economies of scale.

237. Cost variations tend to hinder co-ordination as it makes the behaviour of rivals more difficult to monitor. The cost of providing rentals cars on 12 month or longer contracts tends to be stable as volumes of cars are flexible over this period, i.e. a car rental company can de-fleet in order to reduce excess costs associated with un-utilised fleet. In short periods, the marginal cost of renting a car may depend on fleet utilisation, implying that there may be more fluctuation in cost for leisure car rentals. The relative stability of costs for business car rental enables monitoring of rival behaviour.

238. The Commission considers that the costs of the two firms are likely to be broadly similar and that costs are relatively stable.

Price Transparency

239. Price deviations are easier to detect when price information is freely available, because of the posting of prices, information exchanges or disclosure of price bids. Transparency reduces the cost of detection, and so facilitates the discovery of deviation from coordinated prices.

240. Large corporate rates are usually set through a tendering process, whereby parties are invited to tender for a contract (rates and services). Some of the large corporates give an idea of the total volume of sales that has been transacted in the last 12 months or so to help tenderers. However, none of them said that they had disclosed the rates tendered by the parties after the tendering process.

241. The Commission believes that Budget, Hertz and Avis would have an idea of the amount bid by each of the others as they currently have similar cost structures. Thrifty recognised that it had lost corporate contracts because it was too expensive. Because of its lack of exposure to the corporate market, it was hard for it to know which pricing strategy to adopt and where to position its prices. In comparison, it appears that Budget, Avis and Hertz have developed some knowledge of each other's bidding strategies and prices. However, this is limited by corporate customers not making price information freely available to each of the tenderers.

242. A further factor that reduces transparency is the importance of non-price factors in deciding on bids from rental car providers. This may make it less obvious as to whether a

rival had bid a lower price or offered a higher level of service. However, service quality may to some extent be considered in the same way as prices. Market power may be exercised by reducing quality and holding prices constant, or by increasing prices and holding quality constant. To the extent that service quality is specified in the tender documents or is known by rivals, it will not reduce the transparency of the bidding process.

243. The Commission is of the view that although the structure of the bidding process whereby the winner is known and bidders have developed knowledge of each other's bidding strategies and prices would possibly enable monitoring to take place, prices may not be sufficiently transparent to support the contention that deviation from coordinated prices would be detected.

<u>Ability to Discipline</u>

244. The assessment of the relevant structural and behavioural conditions in the corporate market in Table 3 suggests that there is some potential for discipline to be enhanced post-merger because sellers will be highly concentrated with a similar cost base in a slowly growing market.

245. However, sales to the corporate customers vary significantly in size. Some of the contracts are very large, which will provide strong incentives to cheat to win. These incentives will be exacerbated by the variation in term length and the ability of customers to adjust the term length. Sales to medium to small business customers are smaller and the on-going pattern of corporate tenders throughout the year would decrease the incentives to cheat.

246. Furthermore, prices are not fully transparent, which increases the cost of detection and therefore hinders the discovery of deviation from coordinated prices.

<u>Conclusion on Discipline</u>

247. The Commission considers that the ability to identify and discipline cheating will not exist post-merger.

Conclusions – Coordinated Market Power

248. The Commission considers that the corporate market would exhibit the following characteristics post-merger:

- The market would be highly concentrated;
- The merged entity would have [ ] market share and the second competitor [ ];
- There is only limited differentiation of the product;
- It is likely a viable third player will emerge from either the current Thrifty or National operations to compete in the corporate market in the face of a price increase post merger;
- Currently the fringe competitors have limited competitive clout;
- The firms are likely to face a price inelastic market demand curve;
- Sales to large corporates are large and not frequent. Sales to medium to small corporates are smaller and more frequent;
- There is no vertical integration;
- The market is growing slowly;

- Post-merger the firms will have similar costs;
- Prices are not transparent; and
- The winner of contracts is disclosed or easy to find out.

249. The foregoing discussion sets out a number of factors that suggest that the co-ordination and discipline necessary for collusion are more likely following the merger of Avis and Budget. The increase in concentration appears to be one that facilitates collusion and discipline.

250. However, prices are not fully transparent, which will increase the difficulty of detection from coordinated prices and therefore hinder the ability to discipline. The Commission acknowledges that the lack of price transparency will not necessarily prevent a market sharing arrangement.

251. Furthermore, the outcome of the tender process with just two bidders is transparent, the variation in size of contracts will provide strong incentives for car rental companies to cheat on these contracts. The ability of customers to adjust the term of the contract to will make co-ordination difficult.

252. Finally, there are two fringe competitors that could potentially serve to disrupt collusion. The Commission considers that fringe competitors could potentially constrain behaviour, including collusion by the major suppliers. [

].

253. Therefore, in light of the preceding analysis and evidence, the Commission is of the view that the acquisition, on the balance of probabilities, is not likely to materially enhance the potential for coordinated market power.

Conclusions – Existing Competition

254. The Commission considers that the merged entity will not be able to exercise unilateral market power in the corporate market post acquisition due to the potential for expansion and repositioning by fringe players in the corporate market as discussed below in the section on the *LET* test. Furthermore, the Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

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

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

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

Barriers to Entry

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

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

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

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

262. As mentioned above, car rental companies have to be able to satisfy a certain number of demand side requirements to be able to effectively compete in the corporate market. The Commission has identified some potential barriers to entry and expansion that would prevent new entrants or near entrants to satisfy all those requirement:

- Gaining "on airport" presence;
- Sunk costs;
- Fleet restrictions;
- Restrictions on access to land;
- Long-term relationships between car rental companies and customers;
- Switching costs; and
- Brand and reputation.

Gaining "on airport" presence

263. As explained above, corporates require their preferred car rental supplier to have a booth within the airport terminals for convenience and timely pick-up.

264. At Auckland, Christchurch and Wellington airports, the number of booths and car parks made available to car rental companies and their allocation are determined by the airports.

<u>Limited number of booths</u>

265. All major airports limit the number of booths and car parks made available to car rental companies. The number of car parks allocated to a company is determined by its market share at the airport.

Table 5: Allocation of booths to car rental companies at the three main airports

Airports	**Domestic terminal**	**International terminal**	**Next tender**
Auckland	Budget, Hertz, Avis, National	Budget, Hertz, Avis	2007
Wellington	Budget, Hertz, Avis, Thrifty		2004
Christchurch	Budget, Hertz, Avis, Thrifty		Maybe in 2003

266. As shown in table 5, the number of booths available to car rental companies is limited to four at all of the airport terminals except at the Auckland international terminal where only three operators are allowed (Maui has a booth there but only for campervans).

267. Hertz submitted that it did not expect the number of booths to increase at any of the airports.

268. When it last put the booths out for tender three years ago, Christchurch International Airport Limited (CIAL) limited the number of booths to four. It received bids from four car rental companies and awarded each of them a contract. As there were not more bidders than the number of booths three years ago, CIAL does not anticipate increasing the number of booths for the next tender in 2003. Furthermore, it is not sure whether it will put the booths out for tender or roll the contracts over.

269. When Auckland International Airport Limited (AIAL) put the four booths out for tender in 2002, it received bids from five companies, but one of them – Maui - withdrew (for cars only). It awarded the four contracts to the four remaining bidders. Its aim is to offer choice to customers. It will not allow two different brands in the same booth, as it believes this would confuse customers. Nor does it plan on increasing the number of booths for the next tender in 2007.

270. AIAL has recently allowed "licence B" operators to have an office about 400 metres away from the international terminal. These offices are built by the airport and rented out to car rental companies. The only requirement is to have a license B ("off airport" operation). Three companies have applied so far for an office: ACE, National and ARF. ACE opened its office two months ago. National, which already has a booth at the domestic terminal, [ ]. ARF, a smaller operator of about [ ] second hand cars, will use its office to attract more leisure customers.

271. Wellington International Airport Limited (WIAL) last put its three booths out for tender in 1999. Nine car rental companies asked for the RFP but only four tendered: Avis, Hertz, Budget and Thrifty. Thrifty outbid the three other tenderers and was selected. Wellington airport went back to Budget, Hertz and Avis and told them that the two remaining booths would be re-tendered. Avis, Hertz and Budget agreed amongst themselves that they would share the remaining space available, i.e. they would each have a smaller booth and fewer car parks. WIAL commented that it was unlikely that it would increase the number of licences for the next tender because of space constraints.

272. The number of booths available to car rental companies at each of the three main airports is unlikely to change in the future. Furthermore, Avis and Budget indicated that post-merger they would maintain both brands, and therefore would not free up any booths by merging. Under the current circumstances, only one booth is therefore available to a fourth competitor at each of the three main airports. Thrifty and National currently share these locations with National being in Auckland and Thrifty being in Christchurch and Wellington.

273. As explained above, for a car rental company to become an effective competitor and be able to constrain the three main players, a presence at each of the airports is a prerequisite. The Commission is therefore of the view that the limited number of booths represents a significant barrier to entry.

Length of airport contracts

274. "On airport" licenses are awarded for four years in Wellington and five years in Auckland and Christchurch. As outlined in Table 7, the "on airport" licenses are due to expire in October 2003 in Christchurch, in June 2004 in Wellington and in 2007 in Auckland.

275. As contracts are awarded for four and five years and come up for tender on a staggered basis, a car rental company that would want to enter or expand into the corporate market would have to wait, under the current circumstances, until 2007, that is for five years, to attempt to secure booths at each of the three main airports.

276. National, which already has a booth at the Auckland airport, would be the only car rental company outside Avis, Hertz and Budget able to secure a booth at each of the main airports by the end of 2004, and only if it is successful in winning the next tender in Christchurch and Wellington.

277. The Commission therefore considers that the timeframe attached to the tender processes for "on airport" licences represents a substantial barrier to entry.

Fees

278. The tenders for airport slots are open to all car rental companies. However, the fees required by airports for "on airport" location are such that it is likely that few car rental companies would have the financial resources to pay for them. This is because a minimum guaranteed fee is required and only suppliers with substantial fleets and high daily rates, and therefore significant revenues, are likely to be able to afford them.

279. The fees paid to the airports are determined during the tender process, where the tenderers have to bid for a minimum guaranteed fee and a percentage of their turnover made at the airports. At the end of the year, they will pay the greater of the minimum

guarantee fee or the percentage of their turnover. An example of the fees paid by Avis, Hertz, Budget and Thrifty to Christchurch airport is given in Table 4.

Table 4: Fees paid by the car rental companies at Christchurch airport for the year ending 2002

Company	**Licence minimum Guarantee Sum Year ending 06/02**	**Licence fee (% of the turnover)**	**Fee paid to the airport for the year ending 06/02**
Avis	[ ]	[ ]	[ ]
Hertz	[ ]	[ ]	[ ]
Budget	[ ]	[ ]	[ ]
Thrifty	[ ]	[ ]	[ ]

280. In its submission, Hertz stated that only Hertz, Budget and Avis would have the financial resources to tender for and profit from booths at airports.

281. [ ].

282. [ ]

283. Other large car rental companies such as [ ] stated that they had no intention at this stage to tender for a booth at the airports because of the overhead costs. [ ] said that it might consider it in the future but it had to grow first.

284. The Commission concludes that the fees required by the airports represent a barrier to entry and that only a limited number of car rental companies would have the financial resources to pay them.

Conclusion on airports

285. The Commission considers that gaining access to on-airport licenses represent a high barrier to entry.

Sunk costs

286. A car rental company that wishes to expand or enter into the corporate market would have to:

- Invest in a large fleet of new cars. Thrifty stated that one would need between [ ] and [ ] cars to be able to compete in the corporate market and that the cars would need to be new, or not older than [ ] months;

- Build an extensive network of offices encompassing regional airports and provincial centres;

- Develop a single reservation management system for all rentals in New Zealand; and

- Invest in advertising and marketing to build and maintain brand awareness.

287. These factors may require firms to have a substantial amount of capital and be prepared to commit to a level of sunk costs.

288. However, the Commission does not consider that these factors would in themselves be significant barriers to entry.

- A rental car provider can reduce the level of sunk costs in establishing a national network by using franchisees or agencies to provide service at some locations. All the car rental companies operating in the corporate market are using franchises and/or agencies.

- The vehicle fleet may be leased, which reduces the level of upfront capital required to establish a fleet of brand new cars. Hertz, Budget, Avis, National and Thrifty all lease their vehicles for an average period of [ ] months. The car rental companies that buy their cars operate in the leisure market. Their cars are Japanese second hand cars, which are much cheaper than new cars, and are kept longer - for up to [ ] years.

- The level of marketing and advertising expenditure does not appear to be high relative to sales. Rental car providers do not currently use television advertising. Advertising expenditure on signs and brochures is at least partly scaleable with size. [ ].

289. The Commission considers that the barriers arising from the need to invest in a large fleet of new cars, building a national network and establishing a reputable brand do not in themselves prevent entry into the market, although they may reinforce the barriers arising from limited airport slots.

Restrictions on fleet size expansion

290. Hertz submitted that "restrictions on fleet sizes from restrictions in fleet leases and from manufacturers on fleet numbers" would represent a "restriction on expansion in the market".

291. As a response to Hertz's submission, Cendant and Budget submitted that:

> " For the following reasons the Parties disagree, and indeed consider it lacks credibility to suggest, that any restrictions imposed by manufacturers or lease companies affect the ability of an existing competitor to expand.
>
> (a) The presence of a number of competing tenderers (including, the Parties understand, Tender B operators) at Large Corporate tenders indicates that access to vehicles is not a barrier to expansion in a Large Corporates Market. Neither Avis nor Budget have ever been restricted from expansion by virtue of access to vehicles.

(b) A significant proportion of vehicle manufacturers do not impose any restrictions on fleet size. The parties are unaware of any general restrictions imposed by [ ] nor are they aware of any restriction imposed by Ford. While some manufacturers (e.g. [ ]) restrict the number of vehicles made available to CRCs the availability of vehicles via manufacturers or lease companies that do not impose any such restrictions ensures that an expanding CRC can easily access the required number of vehicles. The Parties acknowledge that from time to time manufacturers will temporarily limit sales to CRCs of new models (to give dealers first opportunity to sell them) but note that such limits do not generally apply to established models.

Again, while some lease companies impose restrictions on fleet size, the large number of competing suppliers (both other lease companies and vehicle manufacturers) ensures that access to vehicles is not a restriction on expansion, much less a barrier to expansion.

The wide availability of vehicles is consistent with the competitive nature of the market for the supply of vehicles – a vehicle manufacturer or lease company would be reluctant to refuse to supply vehicles to a credit-worthy CRC, as doing so would forfeit revenue and allow a competitor to both increase sales and establish a relationship with a CRC.

(c) In the event a particular manufacturer were to restrict supply, there are a multitude of alternative vehicle suppliers available (e.g. if Ford were to refuse supply, General Motors (Holden), Toyota etc. would be alternative sources of supply, as would lease companies such as Orix, Hertz Lease and Esanda (formerly Avis Lease)). Many companies, including Avis and Budget utilise the numerous car leasing companies."

292. Hertz and National's responses to Cendant and Budget's arguments above were the following:

- There are real restrictions on fleet sizes by manufacturers and fleet lease agents from the control they exercise over the release of vehicles. Almost all arrangements with manufacturers are on lease or "guaranteed buy back" terms (with leases being more common). Purchase on guaranteed buy-back is effectively a lease in substance. Manufacturers and fleet lessors place careful controls on the release of additional vehicles to minimise the risk they will later be flooded with vehicles upon buy-back or termination of lease, as they will have to sell cars on the second-hand market and this would push prices down too far. Furthermore, they would put restrictions on brands or models that do not sell well on the second-hand market.

- Fleet lease companies offer rental car companies discounted rates on lease vehicles within fleet limits. Whilst theoretically fleet lease companies could significantly increase supply upon a rental car company wishing to expand its fleet, they are not prepared to offer the discounted rates for an unlimited supply of vehicles. It therefore becomes increasingly uneconomic to fleet up at high levels.

293. The Commission considers that it is in the manufacturers' and fleet lease agents' interest to, and that some do, put limits on the number of cars they make available to car

rental companies, and to offer rental car companies discounted rates on lease vehicles within fleet limits.

294. However, should the merged entity increase its prices by a ssnip and its customers switch to another car rental company, the merged entity would decrease its fleet as soon as the lease contracts allowed. As explained before, Avis, Hertz and Budget use the flexibility of lease contracts to adjust their capacity to demand. This suggests that the extra demand from some companies would be offset by reduced demand from the merged entity.

295. The total pool of cars required by all car rental companies is not expected to increase significantly in the future as the corporate market is only growing at a rate of [ ] per annum. The total increase in demand for cars to lease to service the corporate market is therefore not expected to increase by more than [ ];

296. The Commission also understands that car rental companies deal with several brands and that there are no exclusive supplier agreements. Even Hertz, which is owned by Ford, leases Toyota cars. Avis leases Toyota, Honda, Lexus and Holden vehicles; Budget leases Ford, Holden and Toyota vehicles; and Thrifty leases Toyota, Holden and Ford vehicles. Should a brand put strict limits on the number of cars available to a car rental company, the latter could try to deal with another that does not put such strict restrictions.

297. Furthermore, corporate contracts are only put out for tender every one to three years. Should the merged entity impose a ssnip post merger, this would only affect companies for which contracts are coming to term. Many large corporates said that they would be protected from price increases until the next tendering round. Should the merged entity increase its prices, the switching would occur on an incremental basis, leaving time for car rental companies to adapt the size of their fleet.

298. As submitted by Budget and Avis in response to Hertz's submission:

"In terms of access to vehicles generally, CRC's could secure additional fleet on an incremental basis, as needed, as Large Corporate accounts come up for tender throughout the year."

"…the Parties wish to advise the Commission that in respect of Large Corporate accounts, the typical lead time from completion of the tender process to the date the obligation to supply rental vehicles commences is likely to be longer than in respect of smaller tenders, to allow the successful CRC to secure additional vehicles. Large Corporate tenders usually commence well in advance of the termination of the incumbent contract."

299. Finally, Avis and Budget submitted that:

"Lead times associated with a significant fleet expansion would be no more than three months and the ready availability of cars pursuant to manufacturer "buy-back" arrangements eliminates any sunk costs that might otherwise be incurred in connection with a significant expansion. Indeed, the existence of a robust market for used cars suggests that not even the costs of acquiring cars outright ought properly to be considered as sunk."

300. Most car rental companies confirmed that they could get 100 cars within three months at competitive rates. However, none suggested that they would buy cars, as they would have to sell them after 12 to 15 months in an over-supplied second-hand market and would be losing money. They would only (and some already do) buy luxury cars, as they retain a greater value in the second-hand market.

Conclusion on restrictions on fleet size

301. The Commission considers that the restrictions imposed by car manufacturers or fleet lease agents on the number of cars they make available to car rental companies do not represent a barrier to expansion or entry for the following reasons:

- There are enough car leasing companies and manufacturers from which to source cars, in the event one of them were to limit the number of cars and prevent fleet size expansion;
- Car rental companies do not have any exclusive supplier agreements with car leasing companies and manufacturers and lease cars of different brands;
- The total pool of cars required by all the car rental companies for the corporate market would not change significantly only the share of each firm would change, should the merged entity increase prices. As the merged entity would decrease the size of its fleet in response to the reduction in demand. Large corporate contracts are tendered throughout the year so that switching would occur on an incremental basis, which would give time for car rental companies to secure the additional fleet required;
- Corporate contracts are tendered several months before they are due to start. The lead-time allows the successful car rental company to place orders and get the cars; and
- Lead-time for an order of one hundred cars would take no longer than three months.

Property restrictions

302. The car rental companies that have a booth at the airports are allocated car parks called "ready bays", which are adjacent to the terminals, and are the points where customers pick-up or drop-off rental cars.

303. Whereas the number of ready bays remains constant throughout the concession at Wellington airport, they are reviewed and reallocated every 6 months at Auckland airport and every year at Christchurch airport.

304. Because the number of ready bays is very limited, car rental companies have depots close to the airports where they store cars. They transfer cars from the depots to the ready bays.

305. Hertz submitted that expansion could be restricted because of "property restrictions as purchasing additional land for use as lots is considered likely to prove uneconomic. The prime land for these purposes is, to a large extent, already occupied."

306. In their submission, Cendant and Budget replied:

"No evidentiary support has been provided for the assertion that purchasing additional land for use as vehicle lots is considered likely to prove uneconomic. The Parties believe that most rental car sites would be leased, certainly those at airports. Contrary to the objector's claim, property advertisements indicate that there is ample commercial property available for use as lots outside the three main airports.

"By way of example, Auckland International Airport has recently completed, as it describes, "a purpose built rental car facility for Tender B operator, ACE Rental Cars, including a 35m² office/reception area, workshop and onsite car parking.

"Further, Christchurch Airport has an overflow facility it makes available to Car Rental Companies, and is currently offering additional land to Car Rental Companies.

"Finally, All Tender A Car Rental Companies currently transport vehicles from their larger airport lots to car parks closer to the Terminal. Significant expansion would simply require additional transportation, a requirement that has not deterred expansion in the past, and will not restrict expansion post-acquisition."

307. The Commission has not found evidence that there would be any restrictions put on property or purchase of land. The allocation of ready bays is reviewed and adapted by Christchurch and Auckland airports on the basis of the revenues made by each of the car rental companies with booths. If Hertz's revenues grew as a result of a switching of customers from the merged entity, it will be allocated more ready bays.

308. The Commission considers that purchasing of land to use as slots is not a barrier to entry or expansion.

Long term relationships between customers and car rental companies

309. Large customers usually select their preferred supplier through a tendering process. The duration of the contracts are variable, with the minimum being one year. Some customers have ongoing contracts, which they review from time to time.

310. Most of the large corporates have been with their preferred supplier for more than three years. For example:

- eleven Government Departments that put a common tender out last year negotiated their contract for [ ];
- Fletcher Forest [ ] has been with Budget [ ];
- the Ministry of Education [ ] has an [ ] contract with Avis; and
- Fisher and Paykel [ ] has been with Avis for [ ]

311. TVNZ, whose contract is worth [ ]

312. In its submission, Cendant reported that "Avis New Zealand, based on its own information, estimates that approximately [ ]% of the Large Corporate accounts have switched in the past 5 years. In the last 2 years Avis has lost or gained Large Corporate accounts having a value in excess of $[ ], in respect of a total market segment estimated to be $[ ]."

313. However, Avis was not able to provide the name of any corporate customers lost to any car rental companies other than Budget or Hertz. Therefore, it appears that even though switching does occur, it remains confined to the three main players.

314. Thrifty stated that it would take a considerable amount of time to develop corporate relationships, should it secure a booth at the three main airports and seek to increase its corporate client base.

315. The long-term relationships that seem to exist between the large corporates and their preferred supplier, the reluctance shown by some of them to switch, together with the fact that contracts are not regularly tendered, could represent a barrier to entry or expansion for players outside the three largest companies. Furthermore, some corporates run tenders closed to car rental companies other than Avis, Hertz or Budget.

Switching costs

316. In its submission, Hertz was of the view that switching costs that apply to business customers were high in terms of time and convenience. It pointed to four indicative factors:

- communication of the company's decision to switch suppliers to all staff affected;
- negotiating an agreement with a new supplier, with attendant administrative and legal costs;
- foregoing benefits acquired through loyalty programs with existing suppliers; and
- time expended in overcoming staff resistance to the change.

317. In their response to Hertz's submission, Cendant and Budget stated that;

> "The Parties submit that there are no material switching costs, as evidenced by the frequency with which Large Corporate customers switch from one CRC to another, the prevalence of "flipping" to off-contract CRCs, and contractual terms that permit customers to terminate or renegotiate contracts. Avis New Zealand, based on its own information, estimates that approximately [ ]% of the Large Corporate accounts have switched in the past 5 years. In the last 2 years Avis has lost or gained Large Corporate accounts having a value in excess of $[ ], in respect of a total market segment estimated to be $[ ]."

318. In response to each of Hertz's objections, Cendant and Budget submitted that:

- Communication of a company's switch is simple, and can be accomplished with a single email.

- The time incurred in setting up user profiles for preferential status is incurred by car rental companies, and all that is required from large customers is the provision of certain employee information, e.g. name, drivers' licence numbers, contact details.

- Legal costs are likely to be minimal given the prevalence of 'form contracts'. The time involved in assessing these is unlikely to deter a company from switching to a car rental company that offered more attractive terms.

- Staff resistance to change of car rental company is not a material cost, and any such resistance would be likely to be short-lived within a large corporate.

319. TVNZ was one of the few large customers that stated that switching costs would be high and switching would be cumbersome. Even though its was using a travel agent to book the cars, it said that the proper channels to have a car booked were set up and known by all staff. It would therefore take time to train staff appropriately and would result in significant administrative costs.

320. Most of the corporates recognised that there would be some switching costs, mostly administrative costs, but they either could not quantify them or did not think that these were high, or high enough to prevent them from switching.

321. The Commission does not consider switching costs to be so high as to represent a barrier to entry.

Brand and reputation

322. In its submission to ACCC, Hertz stated that:

> "The Delta/Europcar experience also reinforces the importance of global branding in the Corporate Market. Although brands are utilised to differentiate products, Hertz believes that access to, and the ability to compete in, the Corporate Market requires a significant international brand…."

323. Corporate customers take into account and give weight to the car rental companies' brand and reputation attached to the brand when they choose their preferred supplier, as they seek to minimise the risk of their preferred supplier failing to deliver the cars and services they require. Some of them would only invite the three international brands Budget, Avis and Hertz to tender for their contracts.

324. Thrifty stated that it had to do a lot of marketing during the last three years to build brand awareness amongst the corporates as most of them had never heard of Thrifty.

325. The Commission is of the view that the establishment of a reputable and recognised brand amongst corporate clients would represent a barrier to entry.

Conclusion on barriers to entry

326. The Commission considers that the barriers to entry into the corporate market are high. The main barrier to entry would be getting access to "on airport" licenses.

The "LET" Test

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

Likelihood of Entry

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

329. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

Entry from overseas

330. The applicant submitted that overseas car rental companies such as Europcar and Alamo could enter the market.

331. However, the Commission understands that Europcar is already present in New Zealand through its [ ] stake in National New Zealand. An individual, Phillip Barnett, owns the remaining [ ] and manages the business.

332. In Australia, National was re-branded as Europcar following a franchise agreement with Europcar for a period of 25 years. However, it was decided that the National brand should be retained in NZ, rather than be renamed as Europcar.

333. Europcar Australia said that it [

]

334. Furthermore, Europcar Australia is a 50/50 joint venture between Alamo and Europcar and Europcar is responsible for Alamo operations in Australia. Europcar Australia stated, "It was nonsense to suggest that Europcar or Alamo would enter New Zealand market in any other form than National". It added that expansion into the market was more likely than de novo entry.

335. In its submission to the ACCC, Hertz wrote:

> "…Alamo is the only remaining major international rental car brand that does not compete in Australia. Although it is theoretically possible for Alamo to enter the Australian markets, Hertz believes that it is unlikely. Alamo's United States parent company, ANC Rental Corporation (also a shareholder in National), has filed for Chapter 11 bankruptcy in the US in November 2001."

336. Therefore, the Commission considers that entry from overseas is very unlikely in the future.

<u>Entry and expansion from New Zealand car rental companies</u>

337. National and Thrifty are the only New Zealand car rental companies committed to competing in the corporate market and growing their market shares. Both already have a toehold in the corporate market with respective market shares of [ ] and [ ].

National

338. National entered the New Zealand market in 1992 with two franchises, one in the North Island with 15 cars and one in the South Island with 20 cars. The South Island franchise took over the North Island franchise when the latter went into liquidation in 1998. At this stage, National had [ ] cars and was growing at a rate of [ ] per year.

339. The North Island franchise secured the Auckland booth for the first time in 1996. It tendered again at the beginning of 2002 while it was in merger negotiation with Thrifty, on the basis that the merger would occur it retained the airport booth, however, the merger attempt failed. National estimates that, as a consequence, it will be [ ].

340. Last year, the owner of National [ ].

341. [ ]

342. [ ]

343. Europcar stated that it wanted National to expand in New Zealand. It therefore appears that Europcar is committed to supporting National's expansion strategy in New Zealand.

Thrifty

344. The master franchise was introduced to New Zealand in 1986. The network was expanded through a franchise system, mainly because there was not sufficient capital available to do it any other way.

345. Transport South Limited became involved in the company in the mid 1990s. Its aim was to make Thrifty the fourth largest car rental company in New Zealand and reach Avis, Budget and Hertz's level. For that, it financially supported Thrifty's bids for booths at the Wellington and Christchurch airports in 1999 and 1998 respectively. However, [ ] and went into receivership in 1999.

346. Thrifty was then bought by South Canterbury Finance Limited, its largest creditor. Since then, it has grown its revenue by [ ] and reduced its loss by [ ]. The recent growth has been achieved by developing awareness of its brand and relationships with travel wholesalers; improving the quality of its fleet; its presence at Christchurch and Wellington airports; and marketing initiatives.

347. Although Thrifty is [ ].

348. Both National and Thrifty have a firm intention to acquire booths at each of the main airports to grow their corporate market shares. Both are prevented from gaining many potential corporate customers because they do not have a booth at each of the three main airports. National said that some very large international corporates that had a contract with National worldwide had to use another car rental company in New Zealand because of its absence from airports.

Hertz submission

349. Hertz submitted that:

> "Apart from Hertz, none of the remaining Class A competitors are considered to have the financial resources to increase capacity by any material extent. Class A licensees operate at close to full capacity all year round."

350. The Commission disagrees with Hertz's claim. National and Thrifty's financial situation recently changed when the former sold [ ] of its company to Europcar and the latter was bought by South Canterbury Finance. Both Europcar and South Canterbury Finance have sufficient resources to provide the financial support required by the two car rental companies to get booths at the main airports and then expand their fleet and network.

Expansion of fringe players

351. The Commission considers that it is important to look beyond the current constraint provided by the fringe players in the corporate market to consider the whether the potential for the fringe to expand to a sufficient extent to constrain the behaviour of the merged party over the relevant time period. The Commissions considers that it is unlikely that both players separately would be able to expand post-merger to sufficient extent to constrain the behaviour of the merged as this would require both parties to acquire further slots at major airports. The Commission does however consider that it is possible for one party or both parties acting together to expand sufficiently to constrain the behaviour of the merged party. [

].

352. The evidence from both National and Thrifty suggest that [

]. Airport booths are high cost and appear to require significant number of business customers to ensure cost recovery. The dynamics of the market suggest that the firms will have a strong incentive to merge, enter into joint marketing arrangements or one player will exit the business market. The profitability of an arrangement of some type between Thrifty and National is likely to be enhanced if the Budget/Avis merger resulted in higher prices in the business market. There are no structural or regulatory barriers to an "arrangement" between Thrifty and National that would enable them to compete more effectively. If the price were to increase post-merger this would increase the incentive to enter into this type of arrangement.

353. [

].

354. It is likely that [

].

Therefore, the Commission considers that it is likely that the fringe players in the corporate market are likely to be able to expand in a two year period following the merger to sufficient constrain the behaviour of the merged party.

Extent of Entry

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

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

<u>National and Thrifty</u>

357. As individual firms, National and Thrifty are fringe participants and do not currently operate on a sufficient scale to constrain the pricing of the major car rental companies in the corporate market. The evidence discussed above, demonstrates that most corporate customers do not consider Thrifty or National as a sufficiently close substitute for Avis, Budget and Hertz.

358. However, as explained above, should they secure a booth at each of the three main airports, [ ] would allow sufficient expansion to constrain the merged entity.

Combined National and Thrifty entity

359. In its submission to ACCC, Hertz Australia stated:

> "Hertz's view that entry into the Corporate Market could only happen through acquisition, is evidenced by Europcar's recent entry into the Corporate Market. Europcar is an international brand that represents the current state of evolution of Delta Rental cars, a former 'off-airport' operator. Over a relatively short period of time, Delta effected entry into the Corporate Market through partnership with National in June 2000, then Europcar in October 2000.

360. Delta has acknowledged that its entry into the Corporate Market was heavily dependent upon its ability to link up with an existing corporate rental car provider, stating:

> "Global links with Europcar, National Rental Car and Accor hotel group are projecting Australia's newest rental car entity, Delta Europcar, into the business travel market. Delta Europcar emerged in October when the 13-year-old Australian-owned Delta purchased Europcar's Australian rights, which drove it into the airport market, key location for the corporate traveller."

361. [

]. The combined entity would be able to operate at sufficient extent to be a viable competitor to the merged entity and Hertz, and to constrain the former, should it increase its prices.

Conclusion on extent of entry

362. The Commission considers that National, Thrifty or a combined National/Thrifty entity have the potential to expand in the corporate market and would have sufficient scale to constrain the behaviour of the major suppliers in that market.

Timeliness of Entry

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

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

365. Having an "on airport license" at each of the three main airports (Auckland, Christchurch and Wellington) is a prerequisite for any car rental company that intends to be an effective competitor to the three main players.

366. As explained above, the licenses at the three main airports do not come up for tender until 2003 in Christchurch, 2004 in Wellington and 2007 in Auckland. Furthermore, Christchurch airport stated that it had not yet decided whether it would put the contracts out for tender in 2003 or just roll them over.

367. Any potential new entrant into the corporate market would therefore have to wait until 2007 to have a booth at each of the three main airports and be able to effectively compete against the three main players.

368. National would have the ability to have a booth at each of the three main airports by the end of 2004 as it is already at the Auckland airport. This would mean that Thrifty loses its booth both in Christchurch and Wellington as none of the airports intends to increase the number of "on airport" licences. A merger between National and Thrifty would also enable entry on a sufficient scale to effectively compete in the corporate market. It may also be possible for a National and Thrifty to jointly market their services to corporate customers without a full merger or brand sharing at airports.

369. Both Thrifty and National have international backing, brand support and the finance to establish a significant competitive presence in a timely fashion in the event of a SSNIP price increase by the merged entity.

370. [

]

Conclusion on timeliness of entry

371. Entry or expansion into the market on a scale large enough to constrain the merged entity could be achieved:

(a) At any time by Thrifty and National, if they merged or established a joint venture;

(b) By 2004 if National succeeds in securing a booth both in Christchurch in 2003 (provided the contracts are re-tendered) and Wellington in 2004; or

(c) By 2007 if Thrifty retains its booths in Wellington and Christchurch and gains a booth at Auckland airport.

Conclusion on Barriers to Entry

372. The Commission concludes that the barriers to entry and expansion are high for de novo entrants and car rental companies other than National and Thrifty. Securing an "on airport license" at each of the three main airports (Auckland, Christchurch and Wellington) appears to be the main barrier to entry as these licenses only come up for tender every five years on a staggered basis and are limited in number.

373. National, Thrifty and a combined National/Thrifty (should they merge or establish a joint venture) have the potential to expand in the corporate market and constrain prices in the event of a post-merger price increase in the corporate market.

374. However, only National and a combined National/Thrifty entity would be able to do so within 2 to 3 years. Thrifty has to wait until 2007 to try and secure a booth at the Auckland airport.

375. The Commission considers that given the [

], and the international brand support each company has, it is likely a viable third player will emerge from the current Thrifty or National operations to compete in the corporate market.

OTHER COMPETITION FACTORS

Constraint from Buyers or Suppliers

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

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

378. Cendant submits that the combined entity will be constrained by corporate customers in the corporate market. These customers account for approximately [ ]% of Avis New Zealand's total business and approximately [ ]% of Budget New Zealand's total business.

The tender process

379. Cendant submits that there is aggressive competition for corporate accounts between competing firms when a business tenders for a car rental company contract, and the degree to which large customers constrain the behaviour of suppliers is enhanced by the tender and negotiation processes, which allow large corporate customers to receive and compare a large number of bids at the same time. Cendant also submits that the confidential nature of bids and the increasing presence of Class B operators in the tendering process means competing tenderers must price extremely competitively in order to win the tender. Cendant further submits that the significant number of total accounts

that require the incumbent car rental company to decrease price in response to competitive bids by other car rental companies, and the declining average corporate rates is also evidence of the countervailing power of customers

380. Large customers spoken to by the Commission confirm that the tender process is competitive and that there is some scope to set terms within the negotiation process. Large customers advised the Commission that although price is important, tenders are also often awarded on factors other than price, such as service and the ability to provide sufficient fleet for a customer's rental requirement. However, the Commission does not necessarily consider the presence of a competitive tender process as evidence of the countervailing power of customers.

381. Large customers also confirm that the tender process can attract bidders outside of Budget, Avis and Hertz, and sometimes includes National and Thrifty. However, some large customers restricted their tender process to inviting tenders from Avis, Budget or Hertz only. The evidence from large customers and National and Thrifty indicates that they are rarely successful in the tender process, given the requirements of business customers to have a national network of on airport locations and to provide sufficient fleet as discussed above. Furthermore, no large customers spoken to by the Commission considered Class B operators as a substitute for the services provided by Avis, Budget or Hertz. Subsequently, all large customers spoken to by the Commission are effectively captive to Budget, Avis or Hertz as the provider of their car rental services

382. Large customers give potential tenderers an indication of the likely size of their business, and bids are based on this indication. Large customers spoken to by the Commission indicated that tender proposals are often priced around a similar figure. Large customers also reported being regularly approached by the unsuccessful tenderers for an indication as to why they had failed in the tender. The Commission considers that if each tendering company knows the volume of business before a tender and therefore the likely value of that business, and their reasons for failure after a tender, a knowledge of competitors behaviour can be built up which would erode the confidential nature of individual bids and undermine the price competitiveness of tenders.

383. There is limited evidence from large customers that suggests a company may require the incumbent car rental company to decrease price in response to competitive bids by other car rental companies. However, to the extent that this occurs, it is evidence of a degree of countervailing power. Similarly, the evidence from Cendant of declining corporate rates is evidence of corporate customers having a degree of countervailing power.

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384. The ability of large customers to use countervailing power is influenced by the value of their tender. The majority of contracts between corporate customers and car rental companies are valued in the range of [ ] and, in terms of the value of the corporate market to car rental companies of around [ ], is insufficient to deliver to an individual company significant countervailing power. While some degree of coordination is possible to achieve greater economies of scale and bargaining power, such as in the tender arranged by the Ministry of Social Services, this type of coordination is rare.

385. The Commission considers that the tender process gives large customers a degree of countervailing power in negotiating a car rental contract. However, this degree of countervailing power does not equate to corporate customers having the ability to constrain the behaviour of car rental companies in the present market conditions. The Commission considers that, on the balance of probabilities, large customers would not have significant countervailing power in the tender process in the post acquisition market.

Low switching costs

386. As explained above, the Commission considers that switching costs are low, and the ability to switch would not limit the countervailing power of the large corporates.

387. Large customers advised the Commission that the length of a contract between a business and a car rental company is generally for a period of between one and three years, and market conditions are reviewed prior to or at the cessation of this period. Large customers spoken to by the Commission who haven't switched in the past three years indicated that this was evidence of a successful relationship between the business and a car rental company and not because switching costs were high.

Nature of the contracts

388. Large customers indicate that there is no requirement within a contract that a specified number of car rental hours must be used or rentals must come from a specified car rental company, and hence customers are free to "flip" and rent vehicles outside of their contractual relationship should the price be favourable. However the constraint from flipping is limited by the extent of the difference between leisure and corporate prices. Based on information supplied by Hertz, the Commission considers that leisure rates are unlikely to be sufficient to constrain corporate rates to competitive levels. Furthermore, as the leisure market is highly differentiated, competition from the lower level of the leisure market may not be sufficient to fully constrain prices at the highest level of the leisure and therefore the ability of customers to "flip" to the highest level of the leisure market may not be sufficient to constrain prices in the corporate market. Contracts negotiated between corporates and car rental companies are preferred supplier agreements and not exclusive agreements. Furthermore, the parties to the contracts are usually able to terminate the contracts provided they give a three months notice.

389. The Commission considers that the nature of the contracts and their terms and conditions would enhance the countervailing power of customers.

Conclusion

390. The Commission concludes that the switching costs are low and the nature of the contractual relationship between a customer and car rental customer is such to allow a customer to flip to a more competitive spot rate should one be available. While this ability is likely to enhance the countervailing power of corporate customers, the Commission considers that the countervailing power of corporate customers in the tendering process through which corporate contracts are won would be reduced in the post-acquisition market. As a result of this dynamic feature of the market, the Commission considers that, on the balance of probabilities, the countervailing power of corporate customers will not exercise an effective constraint on the conduct of the combined entity in the post-acquisition market.

CONCLUSION – CORPORATE MARKET

391. The Commission considers that the merger will significantly increase concentration in the corporate market. Furthermore, entry barriers are high and the countervailing power of customers will not impose sufficient constraint on the merged entity's ability to exercise market power.

392. However, the Commission considers that potential expansion of the fringe players: National and Thrifty [ ] in the corporate car rental market is sufficient to counter the ability of the merged entity to exercise unilateral market power.

393. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the corporate car rental market.

ANALYSIS OF EXISTING COMPETITION IN THE LEISURE MARKET

394. As explained in the section on market definition, there appears to be considerable service differentiation in the leisure market, with operators offering different services on the basis of vehicle age, location of offices, ability to make one-way journeys, use of travel wholesalers, proximity to airports and size of fleets and considerable variation in their prices. On the demand side, leisure customers are likely to have a more diverse range of characteristics than business customers. Whereas some leisure customers have requirements very close to corporates' requirements, others are willing to rent cars from off-airport operators and rent older cars. As a result, the leisure market was divided in three tiers:

- The highest tier of the market, where leisure customers exhibit similar demand characteristics as business customers in terms of a recognised international brand, national network of offices, new cars, linkages to international reservation systems or travel wholesalers and booths at major airports. Their providers of car rental services are the same as in the corporate market: Avis, Hertz, Budget, Thrifty and National;

- The second tier of the market where leisure customers would be more price sensitive than the former and would have less stringent requirements in terms of brand, age of cars and airport booths. Their providers would be the likes of Nationwide, Thrifty, Ace, Apex, Omega, A2B rentals, which provide services across the country with a limited national network and offer one-way rental;

- The third teir of the market where leisure customers would use providers providing services in one location or on a regional basis and do not provide for one-way rentals.

395. The Commission also found that, although it may have been possible to define separate leisure markets, this was not required in order to consider the competitive impact of the merger, as any affect from the merger on the top tier of the leisure market would be experienced in the corporate market. The Commission therefore concluded that it would analyse the impact of the merger on leisure customers as one market, but carefully consider the implications of conclusions on the impact of the business market in light of the differentiation in the leisure market.

Market Shares

396. The applicant used the average number of cars registered with the Land Transport Safety Authority to estimate the market shares of each participant.

397. However, fleet numbers vary throughout the year with most of the companies halving their fleet in winter. Furthermore, it is difficult to estimate within the fleet which cars are used by corporates and which car are used for leisure purposes. Fleet market shares are likely to understate the market shares of Avis, Budget, Hertz. Thrifty and National, as these firms rent new higher priced cars and therefore revenue per car will be higher. It is also likely that larger firms and firms in the business market have higher vehicle utilisation and this will also result in fleet size understating Avis, Budget and Hertz market share. The Commission therefore proposes to use the revenues as its primary measure of market share and concentration.

398. The total size of the rental market (business and leisure) was difficult to estimate, particularly because of the high number of small to medium competitors operating in the leisure market. The Commission understands from participants that the total size of the rental market is likely to be between $200 million and $300 million. Market shares of participants in the leisure market have been calculated using [ ] estimate of $318 million for the total rental car market as an upper limit and $200 million as a lower limit. The resulting shares are shown in Table 6.

Table 6: Estimate of the Market Shares in the Leisure Market

Operators	**Revenue ($ million)**		**Market Shares (% of revenue)**			
	As stated by participants	**With Hertz's estimates for Budget and Avis**	**With Hertz's estimates for Budget and Avis**	**As stated by participants**		
Total rental market revenues	**318 million**	**318 million**	**318 million**	**318 million**	**250 million**	**200 million**
Avis	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Budget	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Merged Entity	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Hertz	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Thrifty	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
National	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Maui	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Ace	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Apex	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
A2B	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Nationwide	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Omega	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Kiwicar	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Others	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total Market	[ ]	[ ]	100%	100%	100%	100%

399. Should the acquisition proceed, the merged entity would have between 21% and 37% of the market shares in the leisure market with a three firm concentration ratio of between 31% and 54%. These figures fall within the safe harbours.

First tier of the market

400. As explained above, Avis, Budget, Hertz, National and Thrifty are likely to be the only car rental companies used by the first tier and to a lesser extent by the second tier. The market shares for the first tier are likely to be similar to the market shares for the corporate market and fall outside the safe harbours. However, the Commission considers that the competition implications in this tier of the leisure market will be no worse than in the corporate market, and is therefore satisfied there will be no significant lessening of competition.

Second and third tier of the market

401. With regards to the second and third tiers, the market shares of the merged entity and the three firm concentration ratio are likely to be lower than the estimates calculated for the whole leisure market as the main car rental companies are likely to be less involved.

402. As the transaction is within the safe harbours and there are no exceptional factors, the Commission considers that the transaction is unlikely to cause a significant lessening of competition in this market.

OVERALL CONCLUSION

403. The Commission has considered the probable nature and extent of competition that would exist in the national market for rental car services to business customers (the corporate market) and the national market for rental car services to leisure customers (the leisure market).

404. The Commission considers that the appropriate benchmark for comparison is the status quo, i.e. the counterfactual is the situation where Budget is bought by a party other than Cendant or any of the major car rental companys in New Zealand.

Corporate market

405. The Commission has considered the nature and extent of the contemplated lessening. The proposed acquisition would result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines.

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

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

407. The Commission is satisfied that expansion by fringe competitors in the corporate market is sufficiently likely to restrain the merged entity's ability to exercise unilateral market power.

408. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the corporate market.

Leisure market

409. The Commission has considered the nature and extent of the contemplated lessening. The proposed acquisition would not result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines.

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

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

411. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the leisure market.

DETERMINATION ON NOTICE OF CLEARANCE

412. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition of Budget by Cendant.

Dated this 6th November 2002

MJ Belgrave
Chair