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COMMERCE COMMISSION

Decision No. 365

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

Motor Trade Association (Incorporated)

and

Vehicle Testing New Zealand Limited

The Commission: M N Berry

Summary of Proposed Acquisition: The acquisition by the Motor Trade Association (Incorporated) or an interconnected body corporate of the Motor Trade Association (Incorporated) of a 100% shareholding in Vehicle Testing New Zealand Limited.

Determination: Pursuant to s 66(3)(a) of the Commerce Act, the Commission determines to give clearance for the proposed acquisition.

Date of Determination: 6 August 1999

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CONTAINED IN SQUARE BRACKETS []**

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THE PROPOSAL

- 1 Pursuant to section 66(1) of the Commerce Act 1986 (the Act), the Motor Trade Association (Incorporated) (MTA) gave notice to the Commission dated 23 July 1999 (the application) seeking clearance for it or any interconnected body corporate to acquire a 100% shareholding in Vehicle Testing New Zealand Limited (VTNZ).

THE PROCEDURES

- 2 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. No extension was sought by either party. Accordingly, a decision on the application is required by Friday 6 August 1999.
- 3 MTA sought confidentiality for the fact of the application, and a confidentiality order was made in respect of the fact of the application for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply.
- 4 The Commission's determination is based on an investigation conducted by its staff and their subsequent advice to the Commission.

THE PARTIES

Motor Trade Association (Incorporated)

- 5 MTA was established as an industry association in 1917, and is incorporated under the Incorporated Societies Act 1908. MTA operates as a trade association for its members from the motor trade industry, in accordance with its Rules.
- 6 The MTA currently has approximately 5,000 members. Membership is separated into a number of categories (for example, "Service Station only" and "General Repairer") as prescribed by the Rules. While a membership may include several categories, the MTA represents the interests of all the categories and all of its members as a whole, in accordance with the Rules.
- 7 Approximately 2,700 members of MTA are accredited vehicle inspectors, permitting them to issue Warrants of Fitness.
- 8 The business activities of MTA include industry-specific research, training and education programmes, consultancy services for members, public relations and law reform.

Vehicle Testing New Zealand Limited

- 9 VTNZ is a state owned enterprise established in 1994 under the State Owned Enterprises Act 1986. The shareholding in VTNZ is held by the Crown.
- 10 VTNZ operates a nation-wide network of independent vehicle testing stations, primarily focusing on the issuing of Certificates of Fitness and Warrants of Fitness. VTNZ is also

involved in a range of other vehicle services including vehicle registration, relicensing, and the processing of change of ownership.

- 11 VTNZ performs its functions through a nationwide network of approximately 50 testing stations, and a large number of “outwork locations”, which are essentially smaller scale facilities located in rural areas.

BACKGROUND

Vehicle Inspection Services

- 12 All vehicles using the roads must be inspected regularly to ensure their mechanical and structural fitness. They are inspected every six months but vehicles first registered since 1 August 1987 and less than six years old may be inspected every 12 months. Since 1994 both Warrants of Fitness and Certificates of Fitness can be issued by a person who meets certain requirements specified by the Land Transport Safety Authority (LTSA).

Warrants of Fitness (WOFs)

- 13 Most lightweight vehicles are required to have a “Warrant of Fitness” (WOF) which can be issued at approved garages, or at testing stations operated by local authorities.
- 14 Principally, the accreditation criteria used by the LTSA for WOFs cover such matters as technical competence and experience, and appropriate business premises and facilities. There is no fee involved when seeking to be accredited, and the application (in the normal course) takes 4-6 weeks. A large number of operators throughout New Zealand, including most local garages, now issue WOFs.

Certificates of Fitness (COFs)

- 15 All heavy vehicles (over 3.5 tonnes), with minor exceptions, undergo a more exacting examination for a “Certificate of Fitness” (COF). Taxicabs and rental vehicles also require a COF.
- 16 At present, COFs are issued by VTNZ stations throughout New Zealand, Vehicle Identification New Zealand (operations in Auckland, Christchurch and Timaru), and an independent operator, Lichfield Street Vehicle Testing Station Limited, in Christchurch. The Commission understands that these parties issuing COFs were contracted as “agents” by the LTSA in 1998, following a tender. The contracts are for a five year period.

THE MARKETS

Introduction

- 17 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine

whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of s 47(1) of the Act.

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

“the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.”

- 19 Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*¹ and in the Commission’s *Business Acquisition Guidelines* (“the Guidelines”)². A brief discussion of the methodology follows.
- 20 Markets are defined in relation to product type, geographical extent, and functional level. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, in response to a change in relative prices of the products concerned. A market is the smallest area in which all such substitution possibilities are encompassed. It is in this area that a hypothetical monopoly supplier could exert market power.
- 21 A properly defined market will include products which are regarded by buyers or sellers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension). A market defined in these terms is one within which a hypothetical profit-maximising sole supplier of a product could impose at least a small yet significant and non-transitory increase in price (the “*ssnip*” test), assuming other terms of sale remain unchanged. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product, or offer their product to alternative acquirers.
- 22 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of vertical functional levels, so the functional levels affected by the application have to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the “manufacturing market”, while that between wholesalers and retailers is usually known as the “wholesaling market”.

Product/Function Market

- 23 The Commission considers that the market for WOF inspection services is a separate market from the market for COF inspection services. As discussed earlier, a vehicle either needs a WOF or a COF, and one cannot be obtained when the other is required. As such, there is no substitutability in demand between the two, and a *ssnip* for a WOF would not result in a vehicle owner choosing to obtain a COF, or vice versa.
- 24 Further, there appears to be no supply side substitutability from WOFs to COFs. This is because the specifications for premises for WOFs and COFs are different. The differences include such factors as the minimum turning radius required, minimum access way width, minimum inspection area, and floor capacity requirements. The Commission also understands that there is a limited “pool” of COF inspectors, with COF inspectors required to meet higher qualification and experience standards than those

¹ (1991) 4 TCLR 473.

² Commerce Commission, *Business Acquisition Guidelines*, 1999, 11-16.

required for the issuing of WOFs. It is noted that there is a degree of supply side substitutability from COFs to WOFs, as a business issuing COFs can also issue WOFs. However, the Commission understands that, for issuers of COFs, the issuing of WOFs represents only a small proportion of their business.

Geographic Market

- 25 The Commission considers that the geographic markets for WOF and COF inspection services are “local” markets.
- 26 Vehicle owners at all locations in New Zealand require WOF and COF inspection services. From a demand perspective, the vehicle owner would likely (and all else being the same) have a preference for having the vehicle inspected in the locality where they reside. The extent to which a WOF inspection service in another locality would provide a close substitute would depend upon the extra costs in using the alternative. The major extra cost is likely to be the transport (eg. petrol) cost between the locations.
- 27 The scope for a hypothetical monopolist, in for example Wellington, to impose a *ssnip* (ie. raise the price by at least 5% for at least a year) would depend upon whether vehicle owners could more cheaply switch to alternative inspection providers in, for example, Lower Hutt.
- 28 Commission staff understand that the cost throughout the country of obtaining a WOF varies between \$25-\$35. Imposition of a *ssnip* in these circumstances is highly unlikely to result in vehicle owners switching to alternative providers. Therefore, the application of the *ssnip* test in this instance suggests that the geographic market is a narrow “local” market.
- 29 The situation can be viewed differently for vehicles requiring a COF. It has been suggested that goods vehicles requiring COFs have considerable flexibility as to where to obtain a COF. For example, a goods vehicle which travels regularly between Wellington and Napier could obtain its COF in either Wellington or Napier. With regard to rental cars, COFs will initially be obtained by the franchisor at whatever locality suits the franchisor and, subsequently, will be determined by the rental car company at whatever locality suits the rental car company.
- 30 Despite this degree of flexibility, the Commission considers that vehicle owners are likely to make their decision on where to obtain a COF principally on the basis of convenience and proximity to work or home. The Commission recognises that there may be overlapping local markets for the provisions of WOFs and COFs (with these local markets having similar characteristics) which may amount to a wider, regional market. However, it is considered that the geographic boundary that is most appropriate for consideration of this proposed acquisition is a local market.

Conclusion on Market Definition

- 31 The Commission concludes that the relevant markets are:
 - the local markets for WOF inspection services (the WOF market); and
 - the local markets for COF inspection services (the COF market).

ASSESSMENT OF DOMINANCE

Competition Analysis Overview

- 32 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.
- 33 Section 3(9) of the Act states that a person is in a “dominant position” if:
- ... a person as a supplier or an acquirer of goods or services either alone or together with an interconnected or associated person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market ...
- 34 That section also states that a determination of dominance shall have regard to:
- market share, technical knowledge and access to materials or capital;
 - the constraint exercised by competitors or potential competitors; and
 - the constraint exercised by suppliers or acquirers.
- 35 In *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, the Court of Appeal approved the following dominance standard, adopted by McGechan J in the High Court:
- ...dominance involves more than “high” market power; more than mere ability to behave “largely” independently of competitors; and more than power to effect “appreciable” changes in terms of trading. It involves a high degree of market control.*
- 36 In the Commission’s view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
- the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
 - the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share.
- 37 However, as Tipping J stated in the High Court decision of *New Zealand Magic Millions Limited & Anor v Wrightson Bloodstock Limited* (1990) 3 NZBLC 99-175:
- [M]arket share is not the sole determinant of the presence or absence of dominance or market power. The most that can be said is that dominance is frequently attended by substantial market share but all the other relevant factors must be brought to account. For example, a substantial market share without barriers to entry will seldom, if ever, be indicative of dominance.*

- 38 Accordingly, before a conclusion on dominance is reached, it is necessary to consider all factors listed in s 3(9) and any other relevant factors.

The association between the MTA and its members

- 39 In its application, the MTA submits that each member of the MTA is not interconnected to, or associated with, the MTA because no member is able, directly or indirectly, to exert a substantial degree of influence over the MTA, whether under the Rules (of MTA) or otherwise.
- 40 MTA therefore submits that the MTA does not currently operate or compete in any of the markets in which VTNZ operates or competes. On that basis the MTA submits that the proposed acquisition constitutes a bare transfer of market power (or dominance, to the extent that VTNZ is dominant in any market) and gives rise to no aggregation of business activities.
- 41 MTA provided further submissions to the Commission, supporting its contention that members of the MTA do not have a substantial degree of influence over the activities of the MTA. The result, according to MTA, is that members of the MTA are not the MTA itself or associated with the MTA, for the purposes of this application.
- 42 The Commission notes that MTA is an incorporated society established to protect and advance the interests, including the business interests, of its members. A significant number, approximately 2,700, of those members operate in the market for the provision of WOFs.
- 43 There may in many cases be a potential difficulty in determining whether members of a trade association, such as MTA, may be “associated” with it in terms of section 47(2) and (3) of the Act. However, on the basis of information provided to the Commission, it appears that the 2,700 members of the MTA who presently issue WOFs are independent competitors and are not “associated” with the MTA.
- 44 Therefore the Commission intends to analyse the proposed acquisition on the basis that the MTA is not associated with its members.

The Local Markets for WOF Inspection Services

Market Shares

- 45 Estimating the market shares of the relevant participants is difficult, in the absence of authoritative independent surveys of market information. Further, as the WOF market is characterised by a large number of small independent operators, it is difficult to estimate both individual market shares and the size of the overall market.
- 46 MTA submitted estimations based upon its industry knowledge and experience. The Commission has not sought to confirm market shares, but is prepared to accept MTA’s estimations as a basic starting point for an analysis of the proposed acquisition. On the basis of the information provided to the Commission, an estimation of the market share of the combined entity in the WOF market is shown in Table 1.

- 47 As discussed earlier, the Commission does not regard the MTA as currently operating in the market for WOF inspection services. For that reason, the MTA is recorded as having a nil market share in Table 1 below, and the aggregation that results (as a consequence of the proposed acquisition) is the aggregation of the VTNZ market share only.

TABLE 1
Estimated Market Shares of Participants in the
Market for Warrant of Fitness Inspection Services

Participant	Estimated Market Share
MTA	Nil
VTNZ	[]%
Combined Entity	[]%
AA and Licensed Motor Vehicle Dealers Association	[]%
Independents	[]%
Others	[]%
Total	100%

- 48 On the basis of the above figures, the combined entity's market share falls well within the Commission's "safe harbours" (refer paragraph 36).
- 49 In addition to the low market share, the MTA submits that the combined entity will be constrained by the actions of competitors, including the small independent garages, the AA, and "others".
- 50 WOFs are issued by a large number of operators throughout New Zealand. Most are small, local garages. The Commission understands that members of the MTA that issue WOFs (referred to as "independents" in Table 1 above) currently compete with each other. In addition, members compete with the category of operators referred to as "others" in Table 1 above. "Others" are providers of WOF inspection services that are not members of the MTA. Given the number of participants in this market, and the independence of the large majority of WOF providers, there appears to be strong competition between all operators in the WOF market.
- 51 Further, the Commission understands that entry into the WOFs market is not particularly onerous. As stated earlier, potential entrants must be accredited according to various criteria set by the LTSA. The capital cost involved is principally made up of lease of premises, and mechanical and office equipment. The accreditation period is generally between 4-6 weeks.
- 52 The current nature of the WOF market suggests that there is competitive activity between all participants. The Commission considers that it is likely that this competitive behaviour will continue, should the proposed acquisition proceed.

Conclusion on the Local Markets for WOF Inspection Services

53 The Commission concludes that the combined entity's market share would fall well within the Commission's "safe harbours", and that the combined entity would face competition from independent operators, both those that are members of MTA and non-MTA members, and other existing market participants. Further, entry conditions are not onerous and are unlikely to represent a major barrier to any prospective entrant wishing to enter the market.

The Local Markets for COF Inspection Services

54 As stated earlier, COF inspection services are currently provided by VTNZ, Vehicle Identification New Zealand (operating in Auckland, Christchurch and Timaru), and Lichfield Street Vehicle Testing Station Limited (Christchurch). These services are provided under contract to the LTSA, for a period of five years.

55 The Commission understands that a condition of the VTNZ contract is that it must undertake "universal service", which includes providing COF inspection services in rural areas of New Zealand.

56 No member of MTA currently provides COF inspection services.

Bare Transfer of Market Power

57 MTA has estimated VTNZ's market share at []%. Given this high market share, the expanded coverage that VTNZ can offer over its competitors, and the five year term restricting entry into this market, it may be argued that VTNZ has a dominant position with respect to COF inspection services. For the purposes of this application, the Commission considers VTNZ has such a dominant position.

58 Given that no member of MTA operates in the COF inspection market, MTA submits that the proposed acquisition constitutes a bare transfer of market power, and gives rise to no aggregation of business activities.

59 Section 48 of the Act provides for an exclusion from section 47 of the Act, in the case of a "bare transfer of market dominance".

60 The Commission considers that it is appropriate, for the purposes of this application, to invoke section 48 on the basis that there is no aggregation of market share, but rather a transfer of that share to an entity not currently operating in the market.

Conclusion on the Local Markets for COF Inspection Services

61 There is no aggregation of business activities resulting from the proposal. The Commission concludes that the acquisition is likely to result in a bare transfer of market power.

OVERALL CONCLUSION

- 62 The Commission has considered the impact of the proposed acquisition in the local markets for Warrant of Fitness inspection services.
- 63 Having regard to the factors set out in section 3(9) of the Commerce Act and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.
- 64 The Commission has also considered the impact of the proposed acquisition in the local markets for Certificate of Fitness inspection services.
- 65 The Commission concludes that, for the purposes of this application, the proposal will result in MTA acquiring a dominant position in this market. However, there is no aggregation in business activities. The Commission therefore considers it appropriate to adopt section 48 of the Act, such that the proposed acquisition constitutes a bare transfer of market dominance, and is excluded from consideration under section 47 of the Act.

DETERMINATION ON NOTICE OF CLEARANCE

- 66 Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by the Motor Trade Association (Incorporated), or any interconnected body corporate, of a 100% shareholding in Vehicle Testing New Zealand Limited.

Dated this 6th day of August 1999

M N Berry
Acting Chairman