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COMMERCE COMMISSION

Draft Determination

Note: This is a Draft Determination issued for the purpose of advancing the Commission's decision on this matter. The conclusions reached are preliminary and take into account only the information provided to the Commission to date.

Draft Determination pursuant to the Commerce Act 1986 ("the Act") in the matter of an Application for authorisation of a business acquisition involving:

Ruapehu Alpine Lifts Limited

and

Turoa Ski Resorts Limited (in receivership)

The Commission:	M J Belgrave (Chairman) M N Berry P R Rebstock
Summary of Proposal:	The acquisition by Ruapehu Alpine Lifts Limited of the assets and operations of Turoa Ski Resorts Limited (in receivership).
Draft Determination:	The Commission determines, on the basis of the information provided to date, that it would be likely to decline an authorisation for the proposed acquisition pursuant to s 67(3)(c) of the Act.
Date of Draft Determination:	28 August 2000

CONFIDENTIAL MATERIAL IN THIS DECISION IS CONTAINED IN SQUARE BRACKETS [ ]

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THE PROPOSED ACQUISITION

1. Pursuant to section 67(1) of the Commerce Act 1986 ("the Act"), Ruapehu Alpine Lifts Limited ("the Applicant") gave notice to the Commission on 31 July 2000 ("the Application"), seeking authorisation for the proposed acquisition of the assets and operations of Turoa Ski Resorts Limited (in receivership).

THE PROCEDURES

2. Section 67(3) of the Act requires the Commission, to issue a decision within 60 working days, or such other longer period as the Commission and the Applicant shall agree. Currently, the final determination on the Application will be delivered no later than 24 October 2000.
3. The Commission issues its preliminary conclusion on the Application within 20 working days referred to as a "Draft Determination" for the purpose of advancing its decision on this matter. The conclusions reached are preliminary and take into account only the information provided to the Commission to date.
4. Submissions on the Draft Determination must be forwarded to the Commission by 18 September 2000, as late submissions will not be accepted. This includes all submissions by interested parties and experts.
5. Section 69B of the Act provides that the Commission may hold a conference prior to determining whether or not to give a clearance or grant an authorisation under section 67(3) of the Act. In respect of this proposal, it is likely that the Commission will convene such a conference to be held in Wellington on 4-5 October 2000.
6. The Commission must give clearance to the proposed acquisition under section 67(3)(a) if it is satisfied that the proposed acquisition would not result, or would not be likely to result, in the acquisition or strengthening of a dominant position in a market.
7. If the Commission is not satisfied that the proposed acquisition would not result, or would not be likely to result, in a dominant position in a market being acquired or strengthened, the Commission must nevertheless grant an authorisation for the proposed acquisition if it is satisfied that the proposed acquisition would result, or would be likely to result, in such a benefit to the public that it should be permitted under section 67(3)(b).
8. If the Commission is not satisfied as to the matters referred to in paragraphs 6 and 7 above, the Commission must decline to grant an authorisation under section 67(3)(c).
9. The Applicant sought confidentiality for certain information contained in the notice seeking authorisation, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the notice. When that confidentiality order expires, the provisions of the Official Information Act 1982 will apply to that information.
10. The Commission's Draft Determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission.

THE PARTIES

Ruapehu Alpine Lifts Limited ("RAL")

11. RAL is a public unlisted company registered under the Companies Act 1993. RAL operates the Whakapapa ski field on the northern slopes of Mt Ruapehu in the central North Island, pursuant to a licence issued by the Department of Conservation. RAL provides the following services at Whakapapa: ski lift services, cafeteria services, ski school services, ski equipment hire and sales, grooming, ski patrol, and other facilities required by skiers.

12. RAL has 4,500 shareholders, nearly all resident in New Zealand. The constitution of RAL provides that shares issued by RAL have no right to receive dividends or pecuniary profit, or to participate (in excess of the amount paid on issue of the share) in the distribution of surplus assets on the liquidation of RAL. All profits of RAL are reinvested in the improvement of and development of facilities at the ski area, for the benefit of the public and to promote snow sports. RAL has an exemption from paying income tax pursuant to Section CB4 (l)(j) of the Income Tax Act 1994. This exemption is dependent on RAL maintaining its current objective and constitutional restrictions.

13. Forty five percent of the voting rights in RAL are attached to shares held on behalf of a trust. The trust deed requires the trustees to exercise their rights in such a way as to promote skiing, and other forms of sport and recreation on Mt Ruapehu. The trustees have no power to sell, transfer, or encumber the shares until the date of distribution. The date of distribution is 2058, unless the trustees specify an earlier date by resolution, or if the company is wound up prior to this date.

Turoa Ski Resort Limited (in receivership) ("TSR")

14. TSR is registered under the Companies Act 1993. TSR operates the Turoa ski field on the western slopes of Mt Ruapehu in the central North Island, pursuant to a licence issued by the Department of Conservation. TSR provides the following services at Turoa: ski lift services, ski patrols, ski schools, ski equipment hire and sales, cafeteria, and other facilities required by skiers.

15. TSR is a wholly owned subsidiary of Skifield Investments Limited (in receivership), which is 100% owned by Cairngorm Securities Pty Limited, a proprietary company registered in Melbourne, Australia.

16. TSR was placed in receivership on 2 March 2000, but continues to operate as a going concern.

BACKGROUND

New Zealand Ski Industry

17. The ski season in New Zealand generally runs from mid June to late October, but this varies from season to season as it is dependent on weather conditions. The New Zealand ski industry comprises 13 commercial ski fields and 11 club fields. Commercial fields account for the vast majority of all skier-days in New Zealand.

18. Commercial fields attract a wider range of skiers and have a significantly greater capacity than club ski fields. Commercial fields have a greater range of lift services, generally providing substantial chair lift and T-bar services, and a greater range of on-slope facilities, such as cafeteria services, equipment hire, creche facilities, and ski lessons.

19. Club fields are run by ski clubs and are primarily used by members of associated ski clubs. They tend to be small fields with basic services and limited capacity. Their lifts are generally rope tows or T-bars. Club fields tend to offer on-mountain accommodation and some require walk-in access.

20. Industry sources commented that South Island skiing was generally considered amongst skiers to offer several advantages over skiing in the North Island. These included:

- South Island ski fields generally have more reliable weather, which is reflected in a fewer number of closed days than at North Island ski fields;

- South Island ski fields generally have dry snow conditions and offer skiers powder snow, while snow on the North Island ski fields tends to be wetter;

- the South Island is perceived to offer the skier a greater variety of terrain than the North Island given the proximity of many of the ski fields to each other;

- South Island ski fields tend to have shorter lift queuing times than the North Island ski fields; and

- the South Island ski resort towns, Queenstown in particular, offer skiers a greater range of facilities and non-skiing activities than the North Island ski resorts.

21. Several South Island ski field operators commented that strong North Island ski operators were good for the ski industry as a whole. Given the larger population base in the North Island, the North Island ski fields were considered crucial for expanding the base of skiers in New Zealand, as they generated interest and enthusiasm for skiing amongst North Islanders.

North Island Ski Fields

22. There are two commercial fields in the North Island, Whakapapa and Turoa, both situated on Mt Ruapehu. There are two club ski fields in the North Island; Tukino, which is situated on the eastern side of Mt Ruapehu, and Manganui, which is situated on Mt Taranaki.

23. Whakapapa has 400 hectares of skiable terrain catering for all levels of skier. RAL classify the terrain as 25% beginner, 50% intermediate, and 25% advanced. Whakapapa has an estimated 265,000 skier-days per season, with capacity for 6,500 to 7,000 skiers per day. It is noted from a survey conducted by CM Research[1] that 97% of skiers sampled at Whakapapa were from the North Island.

24. The nearest accommodation centre to Whakapapa is the Whakapapa Village, also situated on Mt Ruapehu. In addition the townships of Taupo and Turangi are also widely used as accommodation bases for people skiing at Whakapapa.

25. Turoa has 400 hectares of skiable terrain, also catering for all levels of skier. TSR classify the terrain as 20% beginner, 55% intermediate, and 25% advanced. Turoa has an estimated 160,000 skier-days per season, with capacity for 4,000 to 4,500 skiers on any one day. The township of Ohakune is the closest accommodation and entertainment base for Turoa. There are also a number of other central North Island towns nearby that are used by skiers for accommodation.

26. Manganui has 60 hectares of skiable terrain, classified as 5% beginner, 30% intermediate, and 65% advanced. Manganui has capacity for approximately 400 skiers per day. It provides rope tows, a ski school, ski patrol, a public shelter (canteen, toilets, ticket office) and ski field accommodation for club members only.

27. Tukino has 20 hectares of skiable terrain, classified as 75% beginner, 20% intermediate, and 5% advanced. Tukino has capacity for 100-300 skiers per day. It provides rope tows, ski school, and ski field accommodation.

South Island Ski Fields

28. There are 11 commercial ski fields in the South Island, the major fields being Mt Hutt, The Remarkables, Coronet Peak, Cardrona and Treble Cone. Mt Hutt, located in Canterbury, has an estimated 160,000 skier-days per season. Treble Cone, located at Wanaka, has an estimated 85,000 and Cardrona, also at Wanaka, an estimated 110,000 skier-days per season.

29. The Remarkables situated at Queenstown has an estimated 60,000 skier-days per season and Coronet Peak, also at Queenstown, an estimated 150,000 skier-days. The above figures were provided by the Applicant and confirmed as reasonable estimations by the NZ Ski Council.

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[1] *Whakapapa Ski Field Final Report*, prepared for Ruapehu Alpine Lifts by CM Research (NZ) Limited, January 1995, referred to in this Draft Determination as "Whakapapa Research Survey".

30. These ski fields are widely regarded as premier destination ski resorts, complemented by the tourist attractions of Christchurch, Queenstown, and Wanaka. International visitors to New Zealand predominantly ski at these ski fields.

31. The other South Island fields include Rainbow, Porter Heights, Mt Dobson, Mt Lyford, Ohau, and Waiorau Snow Farm. These fields are located in Nelson, the Canterbury and Otago regions. These fields range between 10,000 to 30,000 skier-days per season.

Department of Conservation ("DOC")

32. DOC is the government agency responsible for conserving the natural and historic heritage of New Zealand. DOC administers and manages the Tongariro National Park pursuant to the National Park Act 1980.

33. DOC is responsible for the licensing of the ski field operations on Mt Ruapehu. RAL's current licence was issued in 1990, and has a 30 year term with a provision for an extension for a further 30 years. TSR's licence was issued in 1977 and has a 45 year term.

34. The licences are similar in nature and intention, and both require the payment of an annual rental to DOC. Under the terms of Turoa's licence, DOC is required to approve pricing at Turoa, however the Commission understands that this is not currently enforced. The licences require the provision of on-site facilities for skiers, including cafeterias, toilets and shelter.

35. The licences require the ski field operators to have safety plans and codes of practice in place. Both licences specify the season opening and closing dates (1 June to 31 October), and require the fields to stay open subject to weather and snow conditions (also patronage in the case of Whakapapa). The licences applicable to Whakapapa and Turoa both require the ski field operator to provide certain services and facilities that promote the enjoyment of skiing, and to ensure the protection of the national park environment.

New Zealand Ski Council ("NZ Ski Council")

36. The NZ Ski Council is the national organisation engaged in the coordination and management of skiing and snowboarding activities. The NZ Ski Council carries out functions associated with the promotion of skiing and snowboarding, such as the coordination of both national and international marketing initiatives on behalf of industry members, and other agencies such as the NZ Tourism Board. It also acts as a liaison with the media and Government agencies such as the Hillary Commission regarding all snow sports related activities.

Recent Ski Industry Developments

37. Industry participants commented that the ski industry has experienced problems in the past five years due to climatic and volcanic conditions. The North Island ski fields were affected by a lack of snow in 1997, and by volcanic eruptions in 1995 and 1996. All the ski fields in New Zealand experienced a poor season in 1998 due to a lack of snow.

38. The development of new technologies in snow making and grooming equipment has had a considerable impact on skiing in recent seasons. Snow making equipment allows

fields to open in what otherwise might be marginal conditions, and may assist with the early opening in some seasons and extend the length of season overall. Technological advancements in snow making have resulted in equipment that can now manufacture snow in "warmer" temperatures than was previously the case. Similarly, the use of snow groomers has resulted in better and safer snow conditions for skiers.

Decision 357

39. In May 1999 the Applicant applied for clearance pursuant to section 66(1) of the Act to acquire the assets of Turoa Ski Resort Limited. The Commission declined to give clearance for the proposed acquisition on 14 June 1999.

THE RELEVANT MARKETS

Introduction

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

41. 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.

42. Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,[2] and in the Commission's *Business Acquisition Guidelines* ("the Guidelines").[3] A brief outline of the principles follow.

43. Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or able to substitute the same products from other geographical regions, when they are given the incentive to do so by an increase in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit-maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

44. A properly defined market includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" (the *"ssnip"* test), assuming that other terms of sale remain unchanged. The Commission normally employs a *ssnip* of 5 to 10% in testing market boundaries. The

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[2] (1991) 4 TCLR 473.

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

Commission considers that the *ssnip* test provides a useful framework within which to organise and assess the various pieces of evidence relating to market definition, and to test for substitutability, although the process is unlikely to be as precise and scientific as suggested by the precise way in which the test is specified. The Commission is also mindful of the wording of the Act cited above that markets must be defined as "a matter of fact and commercial common sense."

45. Markets are also defined by functional level. Typically, production, distribution, and sale occurs through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next. For completeness, it is often appropriate to define the functional level of the market affected by a business acquisition.

Market Definition

Introduction

46. The market definition principles outlined above are now applied to determining the relevant market or markets in the present Application.

Product Dimension

47. In its previous Decision No. 357 of 14 June 1999 on the Application by RAL for clearance to acquire TSR, the Commission found that the relevant product market was that for the provision of downhill skiing and snowboarding services. This mirrored the approach that the Commission had taken in the first case in the skiing industry it had considered in 1994, except that snowboarding was not then included.[4] In the later Decision, snowboarding was included with skiing as there is no significant difference in the services provided to the two activities by ski fields, and because snowboarders were by then significant users of ski fields. It also appears that some consumers alternate between skiing and snowboarding. In both cases, heli-skiing and cross-country skiing were not included as part of the market definition. On Mt Ruapehu the former is not permitted, and there is limited scope for the latter.

48. The product market definition is taken to include not only the field itself, but the associated facilities and services such as lifts, grooming, ski patrolling and ski school. Related complementary activities such as gear hire and sales, the provision of food and beverages, and creche services, are considered to be part of other markets (see below).

49. In the 1999 case, RAL contended that it competed for customers in a wider winter leisure activities market, which included winter package holidays to the Pacific Islands, and other sporting and recreational activities such as rugby and tramping. The Commission recognised that skiing competed to some degree with other winter leisure activities, particularly for first-time skiers who might not persist with the sport. However, it considered that for the majority of skiers, the characteristics of skiing—particularly the time and cost involved—were such as to differentiate it significantly from other winter leisure activities, such that they were not close substitutes.

50. In the present Application, RAL states that it considers that it operates in the wider "leisure services market", but rather than argue the point, it accepts the Commission's previously adopted product definition of the market. However, it argues that the

[4] *Sepco holdings Limited/Mt Hutt & Alpine Limited*, 22 April 1994, M2243, p. 2.

competitive pressure from other leisure services should be treated as a constraint on that market.

51. During the course of its investigation of the present proposal, the Commission has not uncovered any further evidence that would lead it to change its view on the product dimension of the market. Accordingly, the Commission considers that the relevant product market is that for the provision of downhill skiing and snowboarding services.

52. While it is recognised that all New Zealand ski fields would fall within this product dimension of the market definition, the Commission notes that there is a significant amount of differentiation in the nature and quality of services offered by the different fields. The services vary according to snow conditions, the reliability of the weather conditions, lift capacities relative to demand, ease of access, the terrain, the facilities available for skiers of differing abilities, the provision of ski-related and other amenities, and the associated apres ski or resort opportunities.

53. Differentiation in the services provided by North and South Island fields appears to be reflected in the fact that prices of lift passes vary between fields, with the more popular and better equipped ones being able to charge a premium. A further implication is that North Island skiers may over a period of time visit more than one field to gain new experiences, rather than because one is a perfect substitute for another. Indeed, the South Island ski industry views the Mt Ruapehu fields as stimulating interest in skiing in the larger North Island population, with those who reach intermediate skill levels being likely then to travel further afield to ski in the South Island. To that extent, it could be argued that South Island fields offer services that are complementary to, rather than substitutable for, those in the North Island.

Geographic Extent

54. The two ski fields that are the subject of the present Application—Whakapapa and Turoa—are both located on Mt Ruapehu and are within easy driving distance of each other. Skiers considering a skiing trip in the North Island would largely make their choices between those two fields. The only other options are the club fields of Tukino on Mt Ruapehu and Manganui on Mt Taranaki, but their capacities and facilities are very limited, and the former can be accessed only by four-wheel drive vehicles.

55. Given the proximity of the Whakapapa and Turoa fields, and the comparability of their facilities and services, it seems reasonable to infer that they compete with each other for customers, and hence fall within the same geographic market. Their pricing and other behaviour supports this contention. The prices of their daily lift passes have been identical for the last two seasons, and have not differed by more than a dollar in the last four seasons. When Whakapapa introduced its heavily discounted season pass in April 2000, Turoa rapidly followed suit. Other lesser price discounts targeted at particular customer groups are said to have been introduced on a "tit-for-tat" basis. Some parties have commented that the two fields compete with each other for market share, rather than trying to expand the size of the market.

<u>The Applicant's View</u>

56. The Applicant does not dispute that the two fields fall in the same geographic market. Rather, it bases its approach to market definition on a distinction between "short stay" and "extended stay" skiers, a distinction made in the Commission's previous two Decisions relating to the skiing industry referred to above. The Applicant contends that

the more days in an intended trip, the more likely it is that those skiers will be prepared to travel greater distances and incur greater transportation costs in getting to and from the destination. A greater travelling time and cost becomes more worthwhile when it can be spread over more days of skiing. On this basis, RAL argues that short stay North Island skiers are "captive" to the Mt Ruapehu fields, in that they generally do not look beyond the skiing available on that mountain, from which it follows that the geographic market must be limited to the North Island. RAL claims that the geographic market is much broader for the extended stay category of skiers, such that the Mt Ruapehu fields effectively compete in a national market.

57. RAL then goes on to define short stay skiers as those for whom skiing trips last one or two days (usually over a weekend), whereas extended stay skiers are those whose trips last for three or more days. This contrasts with the Commission's previous decisions, where the duration of an extended stay was taken to be "4/5 days or longer" in the *Sepco* decision, and "5 to 10 days or more" in Decision No. 357. The Applicant supports this view by equating three-day trips with "long weekends", and contending that such trips are more akin to extended than to short stays. It cites the falling real prices of airfares and the increase in the number of direct flights to South Island ski fields as serving to reduce travelling cost and time respectively (to which might be added rising real incomes generally with economic growth, particularly of high income earners), thereby raising the affordability of short trips to the South Island. This, it is claimed, is reflected in the apparently increasing advertising of "short break" ski packages to destinations such as Queenstown in Auckland newspapers.

58. The Applicant also argues that the extended stay category includes holiday-makers who may ski for one or two days during a longer trip to a destination, but who will be motivated by similar factors. It also refers to a 1999 survey of South Island ski fields by CM Research, which found that 44% of the New Zealand skiers were North Islanders.

59. The Applicant has also provided illustrative costs of trips to both the Mt Ruapehu and South Island ski fields from both Wellington and Auckland, on a three day/two night and a seven day/six night basis. According to those calculations, the time and costs of travelling on trips to the South Island may not always be significantly more than those undertaken to the Mt Ruapehu ski fields, which supports the view that there could be a national market.

60. The Applicant points out that visiting overseas skiers, by definition, have to incur the travel costs associated with what, in the domestic context, would be an extended stay trip. Hence, it is argued that for overseas skiers the domestic market is national in extent, although it is admitted that most, particularly Australian visitors, visit the South Island ski fields. Evidence from the Whakapapa Research Survey shows that in 1995 only 3% of the sampled skiers were from overseas.

61. On the basis of these various arguments, the Applicant concludes that there are two relevant skiing markets: a North Island market for "short stay" skiers (since skiers in both Islands typically will not undertake short stay skiing trips in the other Island),[5] and a national market for "extended stay" (and all overseas) skiers.

[5] The Applicant, in its market definition, is prepared to overlook its contention that skiers in the lower North Island undertake short stay trips to the Rainbow field in the upper South Island, which would link that region with the North Island. Instead, it has chosen to treat this factor as a constraint in the ensuing competition analysis.

The Commission's View

62. The Commission takes the view that in assessing the geographic extent of the market, the fact that particular skiers may from time to time visit and ski at a variety of ski fields is not particularly relevant. As indicated, each field provides a bundle of services that is not perfectly replicated by other fields, and skiers are likely to have a taste for variety, especially as they become more advanced in the sport. It is not disputed that most of the fields are substitutes from a technical perspective, in that despite their varying characteristics, they all provide the same broad service, as defined. Rather, the key issue for market definition is one of economic substitutability.

63. In defining the geographic dimension of the market, the issue is whether, if the relative prices of the services offered by the different ski fields were to be changed, skiers' choices would change, such that they would tend to switch from fields whose prices had increased to those whose prices had fallen. In short, if a *ssnip* were to be introduced by the two Mt Ruapehu fields, would it lead skiers to switch to other fields in such numbers that the price rise would prove to be unprofitable, in which case the fields between which switching takes place would fall in the same geographic market? The presence of the other two North Island fields—Tukino and Manganui—are most unlikely to offer a constraint of this kind, because of their very small size and limited facilities. Would the presence of the South Island fields do so? It is quite conceivable that the decisions of extended stay skiers from the North Island as to whether they ski on Mt Ruapehu or in the South Island might not change if the *ssnip* were to be imposed by a combined Mt Ruapehu operator. If the costs of travelling to the South Island were higher, Mt Ruapehu could still be easily the less expensive option. If skiers' choices were insensitive to this relative price change, then it could be argued that the North Island market would be geographically distinct from a South Island market, regardless of the length of stay.[6]

64. The Applicant has argued that the Commission's Application of the *ssnip* test in defining the geographic market in Decision No. 357 was flawed. In that Decision the *ssnip* was applied to the price of lift passes on Mt Ruapehu. On that basis, it was considered there would be no significant switching of either short stay or extended stay skiers to the South Island fields, from which it was determined that the South Island fields were not part of the same market for both categories of skier. However, the applicant considers that skiers' choices are influenced by costs of trips rather than by the prices of lift passes, and that therefore the Application of the *ssnip* to the latter, and the resulting small dollar increase in the lift pass price, is unlikely to identify actual competitors. The Applicant states that ". . . it is unlikely that a significant number of people would go to another field *on that basis alone*." (emphasis in original)

65. The Commission agrees that skiers' choices are influenced by the cost of trips, but emphasises that here the focus is somewhat more narrow. The Act is concerned with proscribing business acquisitions that are likely to lead to dominance being acquired or strengthened in a market. The relevant market is that in which a hypothetical monopoly supplier would find it profitable to raise price for a significant period of time. Both RAL and TSR are suppliers of downhill skiing and snowboarding services only. They

[6] The *ssnip* needs to be applied to the competitive price, normally assumed to obtain in the competitive conditions applying prior to the business acquisition. However, in this case it is not clear what the competitive price might be, partly because of the service differentiation (so that prices are likely to vary somewhat from field to field), and partly because competitive prices are expected to be closely related to costs, but in ski field operation, unit costs are highly sensitive to volumes as fixed costs predominate.

do not supply most of the other services, such as transport and accommodation, which make up the cost of a skiing trip. These other services are complements to, rather than substitutes for, the provision of downhill skiing and snowboarding services. Hence, the focus must be on whether the combined entity would be able to exert market power in that market, rather than in some broader market for skiing and snowboarding *trips* in which it would supply only a proportion of the services required. The Applicant implicitly recognises this later in its Application (pp. 25-26) when, in assessing the scope for detriments to arise from the market power of the combined entity, it focuses primarily on the potential ability of that entity to discriminate between different categories of skiers in the prices of lift passes.

66. To define the market as the Applicant advocates would be similar to arguing, in the case of petrol for example, that the *ssnip* used in defining the petrol market should be applied to the cost of motoring, on the grounds that the purchase of petrol would be accompanied by the purchase of other motoring services. These might include the various costs that are complementary to the use of petrol such as the running, repairs and maintenance costs of the car. This approach would then obscure the ability of petrol suppliers—using the concept of the hypothetical monopoly supplier—to exert market power, just as using the cost of ski trips would hide the ability of a hypothetical monopoly ski field operator to exert market power in its operations.

67. On this basis, the Commission concludes that it is appropriate to apply the *ssnip* to the price of lift passes. It is for the very reason that the price of lift passes makes up only a proportion of the cost of a trip for most skiers, that an entity which gained a dominant position in a geographic market for the provision of downhill skiing and snowboarding services would likely be able to exert significant market power. The Commission notes the conclusion of the Applicant cited at the end of paragraph 64 that the amount of switching between North and South Island fields in response to a *ssnip* as defined is unlikely to be significant.

68. The view that the market is a North Island one is supported by the effect of the introduction prior to the start of the 2000 season of a heavily discounted season pass by the two Mt Ruapehu fields. For a season pass purchased in April the price was only $199, compared to $499 for a July purchase, a discount of 60%. At Whakapapa this led to 95% of the discounted season passes being purchased in April, and overall to a large increase in sales of passes, according to RAL. The South Island fields operators contacted by the Commission in August 2000 reported no discernible impact upon their operations (although some said that more time was needed to be sure), and no response in terms of a reduction in their lift pass prices. If such a large price reduction—albeit on season passes only—had no impact, the much lower price increase associated with a *ssnip* could not be expected to do so.

69. However, the last paragraph sheds light only on the substitutability of the Mt Ruapehu fields in the eyes of South Island and overseas skiers, rather than the reverse. South Island and international visitors ski almost exclusively in the South Island. One piece of pricing evidence that bears on the economic substitutability of the South Island fields for North Island skiers is that the Rainbow ski field in Nelson introduced a discounted season lift pass of $249 for the 2000 season in October 1999, but this apparently caused no reaction by either RAL or TSR in terms of their pricing. Moreover, neither fields' managements mentioned this discount in interviews with Commission staff, nor included it among the factors they had had in mind when they had taken the decision to introduce their own discounted season passes in early 2000.

70. The Applicant's costings of trips are shown in Table 1. These are based on three day/two night and seven day/six night excursions from Auckland and Wellington to Mt Ruapehu, Mt Hutt/Canterbury, and Queenstown. Trips within the North Island assume the use of own car, and those between the Islands assume air transport and then rental car or shuttle. The Applicant uses these figures as the basis for arguing that trips from both North Island cities to the South Island ski fields have rather similar costs to those of trips to Mt Ruapehu, a finding which underpins its view that there is a national market, at least for extended stay skiers.

TABLE 1
The Applicant's Estimates of Skiing Trip Costs Per Person

Length of trip	Trips within the NI		Trips from NI to SI			
	Auckland/ Mt Ruapehu	Wellington/ Mt Ruapehu	Auckland/ Mt Hutt	Wellington/ Mt Hutt	Auckland/ Queenstown	Wellington/ Queenstown
3 day	$570-778	$570-692	$589-743	$479-635	$744-911	$620-787
7 day	$1,024-1,475	$1,019-1,389	$1,439-1,481	$809-1,172	$1,053-1,409	$929-1,285

71. The Commission believes that these costings tend to overstate the costs of North Islanders visiting the North Island fields relative to visiting the South Island fields on two grounds, both relating to car costs on North Island trips. Firstly, the Applicant assumes that two persons travel and share the costs of the trip, so that the cost per person is high relative to the situation where three or more travel as a party, and spread the car cost over more people. With air trips to the South Island, the transport costs cannot be spread in this way. Secondly, the Applicant, drawing upon the estimates published in the *Directions* magazine of the cost per kilometre of owning and running a car, includes all of the "fixed costs" as well as the "running costs", giving a rate of 75.1 cents per kilometre. However, the Commission takes the view that the decision to own a car is taken independently of the decision to use the car on a skiing trip, and hence the cost of the latter should be limited to those that are incremental to that decision, namely the "running" costs. This gives a cost of 18.3 cents per kilometre.[7]

72. The Commission has undertaken its own costings in respect of North Island trips, and these are summarised in Table 2. These costings are intended to replicate those of the Applicant in terms of the cost components included, namely accommodation, car transport to the field, car transfer between accommodation and the field, and lift passes, but they are based upon the lower kilometre rate for car transport, and assume parties of four as well as of two. The range of costs in each Table cell reflect variations in the costs of different classes of accommodation.

[7] AA, *Directions*, May 2000, pp. 52-53. The per kilometre rates quoted above are those for a car with engine capacity of 1601-2000cc. The running cost figure of 18.3 cents has been increased from the AA's figure of 17.1 cents to allow for the increase in the price of petrol between 31 March 2000 and mid-August.

TABLE 2
The Commission's Estimates of Skiing Trip Costs Per Person within the North Island

Length of trip	Auck/Ohakune		Wgtn/Ohakune		Auck/Whakapapa		Wgtn/Whakapapa	
	2 pax	4 pax	2 pax	4 pax	2 pax	4 pax	2 pax	4 pax
2 day	$239-314	$199-246	$197-297	$157-204	$229-319	$193-223	$226-316	$191-211
6 day	$548-758	$501-618	$506-716	$459-576	$538-748	$496-566	$535-745	$493-563

73. The costings in Table 2 suggest that trips from Auckland or Wellington to the Mt Ruapehu ski fields are substantially less expensive than trips to the major South Island ski fields shown in Table 1. Moreover, the application of a *ssnip* to the lift pass cost component, being a relatively small dollar amount, would not make a material difference to the overall trip cost differentials revealed by the comparisons between Tables 1 and 2. This lends weight to the Commission's view that for North Island skiers, the South Island fields are not close economic substitutes for the North Island fields, and therefore do not fall within the same geographic market.

74. Clearly, the Applicant is correct when it states that many skiers from the North Island do ski in the South, although not the reverse to any significant degree, apparently because the South Island provides a greater range and better quality of skiing than the North Island. The Whakapapa Research Survey (p. 58) found that three-quarters of the 366 Whakapapa skiers sampled had skied at some time on at least one other New Zealand ski field, and one quarter had not. In the former group, the skiers had on average visited 2.46 other New Zealand fields. Of those fields, by far the most popular was Turoa, skied by 64% of the sampled Whakapapa skiers, compared to 28% for each of the next most popular fields (Mt Hutt and Coronet Peak). This in itself would suggest that Whakapapa and Turoa are closer substitutes for each other than they are for the South Island fields.

75. A survey of the five major South Island ski fields in the 1999 season found that they were visited by about 105,800 skiers and snowboarders, and these generated about 599,600 skier-days. Of the 105,800 people, 45% were foreign visitors, 31% were South Islanders, and 24% were North Islanders. The last group numbered about 25,000. Duncan Smith of *nzski.com* told the Commission that research suggests that about 20,000 of the 180,000 skiers and snowboarders living in the North Island visited the South Island ski fields each year, which he suggested was a relatively small proportion given the generally recognised superior conditions and facilities in that location (even if only 100,000 of the 180,000 were active every year).

76. Surveys of Whakapapa skiers indicate that about 31% use private accommodation, and that another 9% visit for the day only. This suggests that about 40% of the total may tend to be "captive" to the Mt Ruapehu ski fields to some degree because of the availability of "free" accommodation, or the ability to ski by the day from home.

Conclusion on Geographic Market Definition

77. On the basis of the preceding analysis, the Commission concludes that the relevant geographic market is the North Island.

Functional Dimension

78. The Whakapapa and Turoa ski fields appear to operate largely in a retail market, in which they sell lift passes directly to their skier customers at retail prices. However, it is understood that they can, and do, sell ski field access to travel wholesalers at wholesale rates, which are then bundled with other services into a holiday package for on-selling to retail customers.

79. While it is not particularly germane to the subsequent analysis, the Commission concludes that the relevant function markets are those for the wholesaling and retailing of downhill skiing and snowboarding services.

Conclusion on Skiing Market Definition

80. The Commission concludes that for the purposes of this decision, the relevant market is that for the provision of downhill skiing and snowboarding services in the North Island to both retail and wholesale customers ("the North Island skiing market").

Other Markets

81. Apart from providing downhill skiing and snowboarding services, the Commission also notes for completeness that Whakapapa and Turoa provide several other skiing-related services to customers. These include gear hire and sales, the provision of food and beverages, a creche, and a chains service.

82. The Applicant considers that such services as these fall into separate product markets. It argues that although the provision of these services is related to skiing, a separate purchasing decision is involved; those services are not necessarily provided by ski field operators nor necessarily purchased by ski field patrons; and numerous alternatives are available from off-field suppliers.

83. The Commission has not yet reached any firm conclusions on the extent of these markets, but believes that market power concerns are unlikely to be raised if the present Application were to proceed. For example, there are many places at which skiing and snowboarding gear and chains may be hired or purchased; skiers can take their own food and beverages to the mountain (and consume them in the ski field operator's café); and only one of the two operators presently runs a creche, and so there would be no aggregation of market power from the proposed acquisition. However, the issue is raised here to encourage further submissions and comment.

Conclusions on Market Definition

84. The Commission concludes that the relevant market is that for the provision of downhill skiing and snowboarding services in the North Island to both retail and wholesale customers ("the North Island skiing market").

Questions:

The Commission seeks comment on its approach to market definition. In particular, it raises the following issues:

1. Is there a skiing/snowboarding product market distinct from a broader "winter leisure activities market"?
2. Is the geographic market limited to the North Island?
3. Is the distinction between "short stay" and "extended stay" ski trips relevant to market definition?
4. Should there be a separate market for ski school activities?
5. Are there any related complementary product markets over which the combined entity could gain a dominant position, and which should therefore be analysed separately?

COMPETITION ANALYSIS

Overview

85. Section 67(3) of the Act, when read in conjunction with section 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, although it may still grant an authorisation under section 67(3) of the Act.

86. Section 3(9) of the Act states that a person is in a "dominant position" in a market 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 the market…"

87. 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.

88. In reaching a view on whether a person is in a position to exercise a dominant influence in a market, the Commission considers the foregoing non-exhaustive list of factors, and any other relevant matters which may be found in a particular case.

89. In the Commission's view, as expressed in its *Business Acquisition Guidelines 1999* (p.17), a dominant position in a market is generally unlikely to be created or strengthened where, after a proposed acquisition, either of the following situations exist:

- the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market; or

- the combined 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.

90. 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*." (emphasis in original)

91. The North Island skiing market is considered below to assess whether the proposed acquisition might lead to the acquisition or strengthening of a dominant position.

The North Island Skiing Market

Market Concentration

92. Downhill skiing and snowboarding services in the North Island are currently provided by two commercial fields, Whakapapa and Turoa, and by the Tukino club ski field on Mt Ruapehu, and the Manganui club ski field on Mt Taranaki.

93. The Commission has obtained data from the Applicant and the NZ Ski Council, indicating the amount of skier-days at each ski field. The total skier-days is a figure based upon the industry term "under average snowcover". This term refers to an average season, running from June to October, and uninterrupted by vagaries such as eruptions or lengthy periods of poor weather.

94. The Commission recognises that variable weather conditions will have a direct effect on skier-days. Therefore, any estimation of skier-days for future seasons will of itself prove difficult. The Commission has consulted briefly with the National Institute of Water and Atmospheric Research (NIWA) regarding likely snow patterns in the future. The advice of NIWA suggests that the estimations made by the Applicant are reasonable. Therefore, the Commission proposes to base its analysis on the Applicant's figures, (and confirmed by the NZ Ski Council) represented below in Table 3.

TABLE 3
Estimated Market Share of North Island Ski Fields

Ski Field	Total Skier-Days	Estimated Market Share
Whakapapa (RAL)	265,000	62%
Turoa (TSR)	160,000	37%
Combined entity	**425,000**	**99%**
Club Ski Fields	5,000	1%
Total	**430,000**	**100%**

95. On the basis of the above figures, the combined entity's market share would fall well outside the Commission's "safe harbours" (refer paragraph 89). However, the fact that a proposed acquisition may lead to a market share falling outside these "safe harbours" does not necessarily mean that it will be likely to result in the acquisition or strengthening of a dominant position in a market. Additional factors must also be considered before a conclusion on dominance is reached.

Constraint by Existing Competitors

96. Club ski fields are the only other existing competitors to the proposed combined entity. However, the capacity of club fields is very small. Tukino has a daily capacity of between 100 to 300 skiers. Manganui has a daily capacity of approximately 400 skiers. The lifts provided at Tukino are limited to rope tows, and access to the Tukino field requires a four wheel drive vehicle. Manganui has a T-bar, and two rope tows. Access to the ski field is by sealed road, but requires a 15 minute walk from the car park to the field. A flying fox is used to transfer equipment across the Manganui Gorge.

97. Club fields are generally based around individual ski clubs and family skiing. They have a group of customers who enjoy the smaller crowds, the camaraderie of club skiing, and they are skiers who are not deterred by the limited facilities. Manganui considers itself as an "intermediate family field".

98. Skiers on Tukino predominantly belong to the ski clubs that have lodges there. The operators of Tukino advised that club skiers visit the ski field and stay in the accommodation available at the field. Tukino views its field as "complimentary" to Whakapapa and Turoa, and only attracts a very small number of non-club member skiers. Manganui is similar, with only one lodge at the ski field, belonging to the Stratford Mountain Club.

99. Further, Tukino is operated under a DOC licence with conditions prohibiting any large-scale expansion. This includes such terms as a prohibition against installing chair lifts, and a requirement that the access road remains unsealed, and only suitable for four wheel drive vehicles. Manganui is also operated pursuant to a DOC licence. Large-scale expansion of the Manganui field is unlikely.

100. The Commission notes further that the Applicant accepts that the club fields are unlikely to offer an effective constraint upon the combined entity.

Conclusion on Constraint by Existing Competitors

101. Having regard to the above factors, the Commission concludes that the existing competitors are unlikely to provide an effective constraint on the combined entity.

Constraint by Potential Competition

102. A business acquisition is unlikely to result in any person acquiring or strengthening a dominant position in a market if behaviour in that market continues to be subject to significant constraints from the threat of market entry.

103. The Commission accepts that potential competition can act as a constraint on business activity. An assessment of the nature and extent of that constraint is an integral part of the Commission's assessment of competition and market dominance.

Conditions of Entry

104. Entry conditions, including the nature and height of any entry barriers, must be determined before the threat of new entry, which might constrain the conduct of the combined entity, can be properly evaluated. The potential for entry to the North Island skiing market is subject to six main issues or potential barriers:

- suitable site location;
- DOC consent;
- regulatory requirements;
- high capital cost;
- incumbent response; and
- excess capacity.

Each of these issues is discussed in turn.

Suitable Site Location

105. The securing of a suitable, strategically placed site upon which to develop a ski field is a major entry component. A suitable site would require a number of features, including high altitude, good terrain, exposure to favourable weather conditions, and manageable access.

106. Industry sources advised that the most suitable area to develop a ski field in the North Island would be in the vicinity of Whakapapa and Turoa in the Tongariro National Park. There are no other sites in the North Island upon which a ski field may be developed. However, DOC advised that there were no suitable sites either on Mt Ruapehu or Mt Taranaki.

DOC Consent

107. In the case of a ski field being developed on land managed by DOC, an application for a concession must be lodged with DOC. A full environmental assessment is required for every ski area concession proposal.

108. Based upon the information supplied by DOC, it appears unlikely that ski field extensions or new ski field licences will be issued for Tongariro National Park by DOC. The Tongariro National Park Management Plan 1990-2000 states:

> "No further ski field areas are seen as necessary or desirable during the term of this management plan".[8]

109. DOC advised that no further ski fields would be permitted upon Mt Ruapehu. Ski fields are not usually permitted in national parks, and it would expect very strong environmental opposition to a further ski field being built.

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[8] Department of Conservation, *Tongariro National Park Management Plan, Volume 1*, p.95.

Regulatory Requirements

110. In addition to obtaining the consent of DOC, potential ski field operators are required to meet the resource consent process under the Resource Management Act (RMA), and the National Parks Act 1980.

111. A wide range of parties are likely to lodge submissions or objections to any proposed ski field development, including environmental groups, local Maori, recreational groups, and local residents and businesses. While the consent process for a ski field will depend upon the particular circumstances of the Application, the Commission understands that the process is a lengthy and potentially expensive one, further complicated by the active use of appeal rights under the RMA, should consent be granted.

112. The Commission concludes that the regulatory requirements of the RMA and other legislation are potentially expensive, and are likely to require a lengthy timeframe to satisfy. Therefore, the regulatory approvals required to operate a ski field represent a significant entry barrier to be addressed by a potential entrant.

High Capital Cost

113. Industry parties advised that the development of a ski field offering full facilities requires a substantial capital investment. The level of investment will differ depending on the scale of the ski field.

114. In addition to the purchase or lease of the land, a potential entrant will require capital equipment such as chair lifts, snowmakers, groomers, vehicles, and on-site buildings. A feature of ski field operation is that a significant proportion of an operators costs are incurred before the ski season has begun, and any revenue is received.

115. One South Island operator estimated that the capital outlay for a field with a 3,000 skier capacity would cost between $15-20 million. RAL estimated the replacement cost of its capital assets at between [ ]. It is likely that many of these costs would be sunk costs, with little prospect of recovery should entry be unsuccessful.

116. Further, in the event that an operator wishes to exit the market, it is a condition of ski field licences managed by DOC that the site be returned to its former state. That is, all machinery, equipment and associated buildings must be removed from the mountain. Such an exercise includes the dismantling and removal of chair lifts, and the removal of concrete foundations. The Commission understands that all but one ski field in New Zealand (the exception being Cardrona) are located on Crown land. Therefore, the closure and exit of a ski field requires the careful management of environmental impacts and related concerns. The “clean-up” costs associated with exiting the market are difficult to estimate, however industry sources regarded such exit costs as substantial.

117. The high capital costs and exit costs increase the downside risk from investment in a ski field development, thereby serving to discourage entry in the first place.

Incumbent Response

118. The threat of strategic behaviour by the incumbent appears to be a further factor which may influence new entry into the skiing market by another operator.

119. Incumbent response could include the use of the appeal process under the RMA to thwart entrants, and its ability to formulate a counter-strategy in the time allowed by the slow entry process. This seems particularly likely where the entrant has incurred significant entry costs, and has yet to obtain any revenue, and where the exact date of entry, the start of a particular ski season, is known to the incumbent. In such a situation the incumbent could, pre season, heavily discount the price of season passes. This is likely to have the effect of reducing the "pool" of skiers that would otherwise be available for the new entrant. The ability of the incumbent to price down to marginal cost, which is very low, may be regarded as an advantageous pricing strategy. The prospect of incumbent response in this situation may have a deterring effect on entry.

120. The Commission considers that the prospect of strategic behaviour by the incumbent may constitute an entry barrier.

<u>Excess Capacity</u>

121. All industry parties noted that the two fields in the North Island, and the South Island ski fields, are operating within their "comfortable carrying capacity". Comfortable carrying capacity is a basic design parameter used to describe the optimum number of people who can utilise the ski field at any one time, being guaranteed a pleasant recreational experience and without causing a decline in the quality of the environment.

122. Indeed, the Mt Ruapehu ski fields appear to be operating with considerable excess capacity. The Applicant has provided figures for the 1994 season which was the last of several particularly good seasons for the fields. Over that season, the average number of skiers per day (2,040 for Whakapapa, 1,538 for Turoa) was less than half the lift capacity (5,500 for Whakapapa, and 3,500 for Turoa).

123. Excess capacity in the skiing market may deter potential entrants. The incumbent operator has the ability to reduce prices and increase the number of skiers, at low incremental cost. Such a strategy by the incumbent may reduce the likelihood of entry.

Conclusion: Entry Conditions

124. The foregoing discussion of entry conditions into the skiing market has highlighted the following entry barriers: suitable site location; obtaining DOC consent, obtaining regulatory approvals, high capital cost of entry and exit, the likely incumbent response, and the potential difficulty of entering in the face of excess capacity in the industry at present.

Assessment of the Constraint by Potential Competition

125. In order for the threat of market entry to be a sufficient constraint on the exercise of market power, the Commission's approach is based on the "*lets*" test. Under this test, to constitute a sufficient constraint, entry must satisfy all four of the following criteria: it must be *l*ikely, sufficient in *e*xtent, *t*imely and *s*ustainable.[9] The constraint imposed by potential entry is assessed against the *lets* test.

Likelihood of Entry

126. In order to be an effective constraint on incumbent market participants, entry into the relevant market must be considered likely on commercial grounds. The Commission

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[9] Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 19-20.

earlier has identified and discussed a number of entry barriers which, cumulatively, are likely to make it difficult for an entrant to establish a presence on a commercially viable basis.

127. No industry party identified a likely entrant in the North Island skiing market. The lack of a suitable site, and the knowledge within the industry that DOC is unlikely to issue further licences, results in an industry view that a new ski field in the North Island is highly unlikely.

128. In the unlikely event that a suitable site was found, and a licence was granted by DOC, factors such as the lengthy RMA approval period and the high capital costs (as well as other entry conditions discussed above) are likely to dissuade any potential entrant from establishing a ski field operation in the North Island.

Extent of Entry

129. If entry is to constrain an otherwise dominant firm, such entry must potentially be at a scale sufficient to impact significantly on its behaviour.

130. The Commission has found that while entry on a small scale may be viable, a small field is unlikely to have the facilities and capacity to attract skiers in significant numbers. Rather, a small field will offer limited terrain and facilities. To effectively constrain the conduct of the combined entity, it would be necessary to establish services on a substantially larger scale.

131. Given the lack of a suitable site, it is unlikely that new entry could be achieved on a scale sufficiently large to effectively constrain the combined entity.

Timeliness of Entry

132. Entry must be likely to occur before users are detrimentally affected to a significant extent, if it is to be sufficient to alleviate dominance concerns. The Commission has said that the relevant time period has to be considered on a case-by-case basis. Given the nature of the entry conditions into ski field operation, as discussed earlier, the relevant time frame could be up to five years.

133. There are considerable uncertainties over how quickly a new ski field could be operational, primarily because of the resource consent procedures under the RMA. One ski field operator suggested that entry could be "fast tracked" within three years, but it was acknowledged that this timeframe anticipates few objections under the RMA. Given the National Park status of Mt Ruapehu, and the surrounding environmental concerns, it is likely that a rigorous and lengthy consent procedure would take place. In such circumstances, and given the nature of the entry conditions into ski field operation, the relevant time frame could be at least five years.

134. The Commission concludes that even if the entrant were to overcome the "likely" aspect of the "*lets*" test discussed above, the "timeliness" aspect would raise further difficulties.

Sustainability of Entry

135. Entry has to be sustainable in the sense that it is likely to be profitable in the long-term, otherwise there will not be a lasting economic incentive to enter the market.

136. In the present case, entry is likely to be sustainable, if it were to occur, because of the large capital costs of the ski field, which once committed would serve to deter exit, and the long-term view of the entrant needed to undertake such an investment.

Conclusion on Constraint from Potential Competitors

137. On the basis of the Application of the "*lets*" test, the Commission concludes that while entry into the relevant market might be sustainable, if it were to occur entry is not likely, nor of sufficient extent, and would not occur in a timely manner so as to alleviate dominance concerns.

138. On the basis of information available, the Commission is not satisfied that the threat of new entry is likely to impose sufficient constraint on the combined entity to avoid dominance concerns.

Constraint from Extended Stay Skiers

139. The Applicant has submitted that all New Zealand ski fields compete for North Island extended stay skiers. In addition, the Applicant also contends that the attractiveness of short stay packages to the South Island ski fields does put pressure on both Whakapapa and Turoa, and so should be considered as a constraint.

140. While the Commission has not considered it necessary to draw a distinction between "short stay" and "extended stay" skiers (as discussed earlier in paragraphs 62 to 76), it has considered the Applicant's submission that extended stay skiers would provide a constraint upon the behaviour of a combined entity operating the ski fields on Mt Ruapehu.

141. Industry sources estimated that there are approximately 180,000 skiers resident in the North Island. Of this number it is estimated that 20,000 travel to the South Island to ski each season. The remainder are considered "captive" to the North Island fields. Of the estimated 20,000 that do travel to the South Island, it is generally the case that these skiers will make only one such trip during the ski season.

142. The Commission has considered whether this group of skiers actually provides an effective constraint on North Island ski fields. Industry comments were to the effect that they do not, and that the cost of such a trip is unlikely to deter these select skiers from continuing to ski in the South Island. However, the Commission notes that these skiers only make up a small percentage of North Island skiers.

143. For the reasons given, the Commission does not consider that extended stay skiers will provide an effective constraint upon the combined entity. As discussed earlier, the market power of the combined entity manifests itself in the ability to increase lift pass prices, not with regard to the overall cost of skiing and snowboarding trips.

Conclusion on Constraint from Extended Stay Skiers

144. The Commission does not consider that extended stay skiers are likely to provide an effective constraint upon the behaviour of the combined entity.

Constraint from Rainbow Ski Field

145. The Applicant has submitted that the Rainbow ski field at St Arnaud in the Nelson Lakes region of the South Island provides a constraint against the behaviour of the North Island ski fields. The Applicant submits that this is due, in part, to the

introduction of fast ferry services across Cook Strait. The Applicant considers that the reduced travel time has resulted in Rainbow becoming a "serious option for weekenders", and anticipates that the trend towards reduced travel times will continue.

146. The Commission understands that Rainbow attracts its skiers principally from the immediate Nelson and Marlborough region. While Rainbow is marketed in both Auckland and Wellington, North Island skiers account for only [ ]% of the skiers at Rainbow at present. [ ]. The Commission understands further that Rainbow is more focused on the beginner and intermediate skier, rather than the advanced skier, and does not offer as full a range of services and facilities as other South Island ski fields.

Conclusion on Constraint from Rainbow Ski Field

147. The Commission acknowledges that Rainbow ski field may provide some degree of competitive pressure on the behaviour of North Island ski fields. However, for the reasons discussed above, the Commission concludes that Rainbow is unlikely to provide an effective constraint upon the combined entity.

Constraint from Other Leisure Activities

148. The Applicant has submitted further that the suppliers of other leisure activities would also provide a constraint upon the combined entity. For example, the Commission understands that the Applicant considered the likely attraction of the WestpacTrust Stadium in Wellington when evaluating its pricing options for 2000, as well as other activities such as winter holiday packages to South Pacific destinations.

149. The Commission considers that other leisure activities are not directly substitutable for skiing. While it may be the case that the consumer has a number of options for its discretionary leisure spending, this is not so for skiers wishing to undertake skiing activities. The Commission acknowledges that some degree of competitive pressure may be exerted by other leisure activities. However, it is not considered that these other leisure activities are such that they provide an effective constraint upon the combined entity.

Conclusion on Constraint from Other Leisure Activities

150. The Commission concludes that other leisure activities are unlikely to provide an effective constraint upon the behaviour of the combined entity.

Conclusion on Dominance in the Skiing Market

151. The proposed acquisition would lead to a level of aggregation well in excess of the Commission's safe harbour guidelines.

152. The Commission has found that the existing competitors are unlikely to provide an effective constraint to the combined entity. In addition, the combined entity is unlikely to be constrained by the potential entry of a competing ski field operator.

153. The Commission further concludes that the combined entity is unlikely to face an effective constraint from extended stay skiers, nor from the Rainbow ski field.

Similarly, the Commission does not consider that other leisure activities provide an effective constraint upon the behaviour of the combined entity.

154. The Commission therefore concludes that it is not 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 the market for the provision of downhill skiing and snowboarding services in the North Island to both retail and wholesale customers.

PUBLIC BENEFITS AND DETRIMENTS

Introduction

155. Given the conclusion that the Commission is not satisfied that the proposed acquisition would not result, or would not be likely to result, in the combined entity acquiring a dominant position in the market set out in paragraph 154 above, the proposed acquisition cannot be cleared under s 67(3)(a) of the Act. The Commission must therefore consider whether the proposed acquisition can be authorised under s 67(3)(b) of the Act.

156. The authorisation procedure requires the Commission to identify and weigh the detriments likely to flow from the acquiring of a dominant position in the relevant markets, and to balance those against the identified and weighed public benefits likely to flow from the proposed acquisition as a whole. It is important to note that the detriments may only be found in the market or markets where dominance is acquired or strengthened, whereas benefits may arise both in those and in any other markets. Only where the benefits clearly outweigh the detriments can the Commission be satisfied that the proposed acquisition will result, or be likely to result, in such a benefit to the public that it should be permitted, and thus be able to grant an authorisation for the proposed acquisition.

157. The principles used by the Commission in evaluating detriments and benefits are set out in: *Guidelines to the Analysis of Public Benefits and Detriments* ("the Guidelines"), a revised version of which was issued by the Commission in December 1997. The various issues raised have been discussed in a number of decisions by the Commission and the courts in recent years. In assessing both benefits and detriments the focus in those decisions has increasingly been on economic efficiency. For example, the Court of Appeal stated in *Tru Tone Ltd v Festival Records* that the Act:

> . . . is based on the premise that society's resources are best allocated in a competitive market where rivalry between firms ensures maximum efficiency in the use of resources.

158. The Commission considers that a public benefit is any gain, and a detriment is any loss, to the public of New Zealand, with an emphasis on gains and losses being measured in terms of economic efficiency. In contrast, changes in the distribution of income, where one group gains while another simultaneously loses, are generally not included because a change in efficiency is not involved. The Commission is also mindful of the observations of Richardson J in *Telecom*[10] on the Commission's responsibility to attempt to quantify benefits and detriments where and to the extent that it is feasible, rather than to rely on purely intuitive judgement. This is not to say that only those gains and losses that can be measured in dollar terms are to be included in the assessment; those of an intangible nature, which are not readily measured in monetary terms, must also be assessed.

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10 *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429,447.

The Counterfactual

159. The benefits and detriments likely to flow from the proposed acquisition in the future have to be assessed against a counterfactual of what might otherwise happen in the future in the absence of the proposed acquisition. Thus, a comparison has to be made between two hypothetical future situations, one with the proposed acquisition and one without. The differences between these two scenarios can then be attributed to the impact of the proposed acquisition in question. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.[11]

160. As the Applicant notes, in many business acquisitions the most likely counterfactual is a continuation of the *status quo*, with both businesses in the absence of the proposed acquisition continuing to operate under separate ownership. In the present case this is not likely to happen, as TSR is in receivership, and the Receiver has indicated his intention to sell the assets and business of TSR. If the preferred sale to RAL were not to proceed because of authorisation being declined by the Commission, another purchaser will be sought by the Receiver. Hence, RAL contends, and the Commission accepts, that the counterfactual is very likely to involve the sale of TSR to another purchaser.

161. The Commission understands that three final bids for TSR were received by the Receiver, of which RAL's bid was one. Of the other two bids, one was from [

].

162. On the basis of this and other information, the Applicant considers that the counterfactual is likely to involve the sale of TSR (probably in 2001) to a purchaser with three possible characteristics: a small company of ski enthusiasts; limited experience in owning and operating a ski field; and the likelihood of a foreign national as a significant shareholder.

163. The Commission's understanding of the situation broadly mirrors that of the Applicant, although it does not at this stage necessarily share the Applicant's views as to the likely characteristics of the counterfactual buyer. While the alternative buyer may have less experience in operating a ski field than RAL, it would no doubt be able to draw upon the expertise of experienced management and staff, and by definition it would have likely paid less for its acquisition than would have RAL.

Conclusion on the Counterfactual

164. For the purposes of this Draft Determination, and to encourage comment, the Commission will, in assessing detriments and benefits, employ a counterfactual wherein the business and assets of TSR will be sold as a going concern to a new ski field operator other than RAL.

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[11] See the discussion in: Commerce Commission, *Decision No. 277: New Zealand Electricity Market*, 30 January 1996, especially p. 16.

Question:

6. The Commission seeks the views of interested parties as to the likely counterfactual should the proposed acquisition not proceed, and the various likely features of that counterfactual.

DETRIMENTS

165. Given the preceding analysis and conclusions, detriments are expected to arise from the loss of competition implied by the combined entity acquiring a dominant position in the North Island skiing market. As noted above, the Commission uses an economic efficiency approach to the measurement of detriments. The assessment is carried out under the following headings: allocative inefficiency, productive inefficiency, dynamic inefficiency and product quality.

166. The Applicant claims that detriments are likely to be limited because of the juxtaposition of two factors: the combined entity would only be dominant in respect of short stay skiers, who it claims generate only a small proportion of total skier-days (the majority being provided by extended stay skiers); and as the two groups of skiers consume the same services, and the combined entity would not easily be able to discriminate between them, it would be unable to exploit its market power over the former without losing the custom of the latter. That in turn would constrain the combined entity from behaving inefficiently.

167. The Applicant contends that a major factor hindering the ability to price discriminate is the fact that short and extended stay skiers alike largely buy single day lift passes, with only 4% of revenues in 1999 coming from sales of multi-day passes. This behaviour apparently reflects the variability in the weather conditions on the Mt Ruapehu fields, such that skiing cannot be guaranteed over a number of successive days. However, the Commission also notes that in its public benefit claims, the Applicant implies (p. 33) that should the two fields be operated under one ownership, skiers would be more willing to purchase three day passes useable at either field. This, presumably, would facilitate price discrimination. Similarly, with the greater popularity of season passes this season because of the price discounting, they have come to occupy a substantial part of the business.

168. However, as argued above, the Commission considers that the market covers both short- and extended stay skiers and snowboarders, and therefore the combined entity's ability to exercise market power or behave inefficiently would not depend upon its ability to discriminate between the two categories. Consequently, the Commission does not accept that detriments would be at the insignificant levels suggested by the Applicant.

Question:

7. The Commission seeks comment on the scope for a ski field to price discriminate between different classes of customers, particularly where that field may have a dominant position in the market.

Allocative Inefficiency

Introduction

169. Subject to certain limited reservations, the economy's resources are allocated between competing alternative uses with maximum economic efficiency when, in any given market, the additional cost of producing the last unit of the good or service equals the price which a buyer is prepared to pay for that unit. Using economic theory, that optimum point is found where market demand equals market supply. Using the general market diagram shown in Figure 1, the intersection at point B of the competitive demand (D) and cost curves for a particular product determines the optimum price and output quantity of P_c and Q_c respectively. The market unit cost curve is assumed to be horizontal so that average cost (AC) equals marginal cost (MC).

170. The outcome would be less than optimal if fewer units were to be produced, as illustrated in Figure 1 by the output Q_m. Here, the price which buyers would be prepared to pay for one more unit (P_m) would exceed the cost incurred in producing that unit (equal to P_c), implying that the benefit to the economy from greater production of the product (as measured by buyers 'willingness to pay') exceeds the sacrifice in terms of the resources used up (as measured by the costs of production). This also applies to the other units of output between Q_m and Q_c. Thus, the shaded triangular area ABC based on that range of output represents the economic loss from the under-production of the product at Q_m. This triangle is a measure of the detriment from the loss of allocative inefficiency—often called the deadweight welfare loss—which potentially could result from the loss of competition in the market.

171. In addition, the area in the Figure shown by P_cP_mAC represents the size of the surplus transferred from buyers to suppliers through the higher price paid. Since what buyers lose by paying the higher price for the Q_m units consumed is exactly offset in dollar terms by the extra surplus earned by suppliers, the social impact is generally taken to be zero. However, the presence of such monopoly rents can weaken the firm's incentives to maintain productive efficiency (see below), and thus indirectly can harm efficiency.

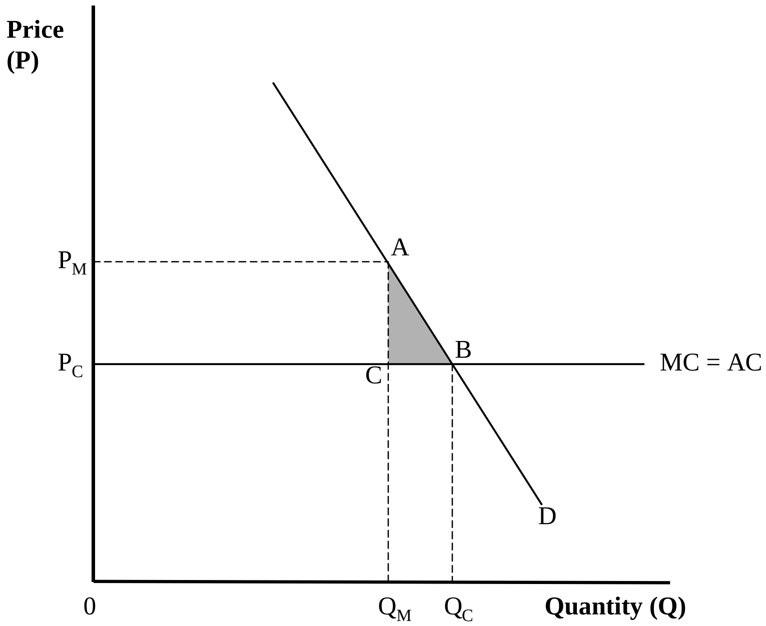
172. The size of the deadweight loss triangle depends upon the following factors:

- the price elasticity of demand and of supply (i.e., the responsiveness of buyers and of suppliers respectively to changes in price) in the market;

- the extent to which the production volume falls below the allocatively efficient one or, alternatively, the extent to which price rises above the competitive level; and

- the size of the market, as measured by the total dollar outlay (represented by area OP_cBQ_c in Figure 1).

FIGURE 1
A Model of Allocative Inefficiency in a Market



173. The size of the wealth transfer depends upon similar factors, but is much larger because it reflects the impact of the price elevation across the whole range of the remaining output produced, whereas the deadweight welfare loss measures the impact of the price rise on the output no longer produced at the margin.

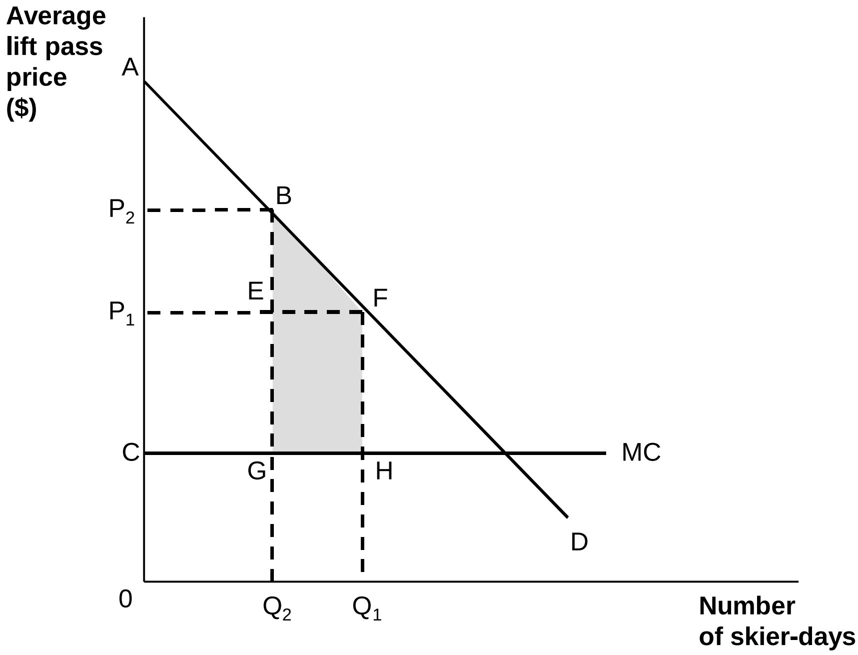
The Applicant's Claim

174. The New Zealand Institute of Economic Research (NZIER), acting as economic adviser to the Applicant, is of the view that for the reasons outlined earlier, the combined entity would be unable profitably to raise prices above the competitive level. It believes that a small group of skiers would respond by going to other fields, and a larger group would either stop skiing, or ski less frequently. The resulting reduction in skier-days would be such as to lead to the price increase being unprofitable. However, even if a price rise were to eventuate, it considers that the deadweight loss from allocative inefficiency is, as a matter of principle, likely to be small.

The Commission's View

175. The Commission has made clear its preliminary view that the relevant market is that for the provision of downhill skiing and snowboarding services in the North Island, and that the combined entity would acquire a dominant position in that market. Hence, the combined entity would be in a position to exert market power by profitably raising price, and so to produce the allocative efficiency and income transfer affects examined generically in Figure 1. However, the model has first to be adjusted to reflect the specific circumstances of the relevant market. This is done in Figure 2.

FIGURE 2
Estimating Allocative Inefficiency in the Skiing Market



176. The vertical and horizontal axes of Figure 2 are scaled in terms of average lift pass price and number of skier-days respectively.[12] The cost structure of the combined entity is such that fixed costs make up a large proportion of total costs, with the result that marginal costs are very low so long as excess capacity, of which there is typically a substantial amount, exists.[13] All of the ski field operators consulted by the Commission emphasised that the large proportion of fixed costs and the low marginal costs per skier-day were critical features in the pricing and financing of a ski field operation. This also meant that data were available to estimate short-run, but not long-run, marginal cost. Furthermore, in the competition analysis above it was shown that for various reasons, the expansion of industry capacity is likely to take a long time to put into effect. Hence, within the short- to medium-term timeframe of the Commission, the industry operates on the short-run marginal cost curve. The NZIER, in its benefit claims, also implicitly assumed a short-run framework. For these reasons, it is the short-run (rather than the long-run) marginal cost curve which is depicted in Figure 2.[14]

177. However, the industry must cover all of its costs, including fixed and overhead costs, and so prior to the acquisition the price is set well above marginal cost at P_1, with output at Q_1. At this position, gross surplus is represented by the area $OAFQ_1$, from which costs of $OCHQ_1$ have to be deducted. The remaining net surplus (or net benefit from production) is split between consumers surplus of P_1AF and producers surplus of CP_1FH.

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[12] For ease of analysis, "skiers" and "skier-days" may henceforth be taken to include snowboarders unless the context indicates otherwise.

[13] This has to be qualified to the extent that all else being the same, demand for skier-days is much higher at weekends than during the week at the North Island fields.

[14] It should be noted that the choice of a short-run marginal cost framework to evaluate the welfare effects of the proposed acquisition will have the effect of tending to increase the magnitudes of both detriments and benefits.

178. After the proposed acquisition when the price rises to P_2 and output in consequence shrinks to Q_2, there is a loss of net surplus equal to the area BFHG. This loss is shared between consumers (BFE) and producers (EFHG). The resources no longer required because of the reduction in output, represented by the area GHQ_1Q_2, are assumed to be absorbed elsewhere in the economy, with no impact on welfare. The additional surplus gained by the combined entity at the expense of consumers, depicted by area P_1P_2BE, is treated as a welfare-neutral wealth transfer. Hence, the detriment arising from the loss of allocative efficiency is represented by the area BFHG.

179. The purpose now is to attempt to estimate the possible magnitudes of the loss of allocative efficiency and the wealth transfer by calibrating the model in Figure 2. The assumptions used are set out in the following paragraphs.

180. The Applicant has calculated that the weighted average price of a lift pass on Mt Ruapehu is expected to be $[   ] in the 2000 season. The fact that this figure is well below the day lift pass price of $54 reflects various factors, including the following: youth rates, half-day and multi-day discounts, school rates, lower mountain rates, sightseeing rates, and the exclusion of GST.

181. The number of skier-days on the two fields is expected by the Applicant to number 425,000 for the current season. The Applicant claims that this estimate reflects the numbers that would eventuate in an average snow year.

182. Consequently, for the purposes of this exercise, the Commission takes the current price as being $[   ], and quantity as being 425,000. The product of these two figures indicates that the combined RAL/Turoa is projected by the Applicant to yield revenues from "ski field operations" of $[   ] in the base year 2000. This may be taken to represent the size of the defined North Island market, if the tiny club fields at Tukino and Manganui were to be ignored.

183. The price elasticity of the demand curve for skiing trips is unknown, and so a plausible estimate has to be made. As a leisure activity which involves the expenditure of a significant amount of discretionary income, it seems likely that demand will be in the elastic range, i.e., exceeding one in absolute terms. On this basis, it is assumed for the purposes of calibrating the model that the likely value will be found in the range between –1.0 and –2.0. However, this is the assumed price elasticity of demand for skiing *trips*, where the price in question is the price of a trip. A trip comprises a number of component services, each with its own demand, such as transport, accommodation and ski field services. Because the cost of one component typically accounts for only a small proportion of the total cost of a trip, any change in its price will have only a muted effect on the price of the final product, and hence in demand for the trip. Consequently, the price elasticity of the demand for the component will be lower (in absolute terms) than the price elasticity of the trip as a whole. The price elasticity of a component's demand curve can be calculated by multiplying the price elasticity of the trip by the proportion of the cost of the component to the price of the trip.

184. As discussed earlier, the Commission has estimated the costs of skiing trips per person, involving two and six night stays, to Turoa (based in Ohakune) and to Whakapapa (based in National Park), comprising accommodation, own car transport from Auckland or Wellington, car transfer to and from the ski field, and daily lift passes. These estimates reveal the proportion of the cost of trips made up by the skiing component. The proportion varies widely from about 32% to 71%, depending mainly upon the

standard of accommodation chosen, and whether trips are made by two or four people. These percentages would vary if different assumptions were made: they would be somewhat lower for those hiring gear, or with shorter travelling distances, or with access to private accommodation, or with season lift passes; and higher for those travelling alone. For the purposes of the estimates of allocative inefficiency, a mid-point proportion of 50% (0.5) is used. Using the assumed upper and lower values for the elasticity of demand for a trip given above of –2.0 and –1.0, the implied price elasticity of demand for ski field services would be –1.0 (i.e., -2.0×0.5) and –0.5 (i.e., -1.0×0.5) respectively.

185. In Figure 2 the marginal cost curve was drawn horizontally at a low level. Estimates by the Applicant of how the costs of the combined entity would increase in response to the expected increase in skier-days in the future have allowed the Commission to estimate the marginal cost per skier-day as being $[ ].

186. The discussion in the last several paragraphs on the calibration of the model can be summarised in the following assumptions:

- a market size of $[ ] in the base year of 2000;
- an average lift pass price of $[ ], and quantity of 425,000 skier-days per annum;
- a price elasticity of demand for ski field services in the range from –0.5 to –1.0; and
- constant marginal cost of $[ ] per skier-day.

187. Using these assumptions, the magnitudes of the potential annual deadweight welfare loss and wealth transfer can be calculated using different forecasts about the size of the possible post-merger increase in price (P_cP_m). Some illustrative examples are given in Table 4.[15]

TABLE 4
Estimates of Annual Allocative Losses and Wealth Transfers in the Defined Market (Rounded)

Hypothetical Price Increase	Price Elasticity = -1.0		Price Elasticity = -0.5	
	Allocative Efficiency Loss	Wealth Transfer	Allocative Efficiency Loss	Wealth Transfer
1%	$91,000	$105,000	$46,000	$106,000
5%	$467,000	$504,000	$233,000	$517,000
10%	N/A	N/A	$480,000	$1,007,000
20%	N/A	N/A	$1,013,000	$1,909,000

Note: N/A denotes "not applicable", as in this scenario profit would be maximised with a price increase of 7.2%.

[15] The formula for calculating the dead-weight welfare loss (W) triangle BFE is: W = 0.5×ΔP×ΔQ×M, where ΔP is the percentage elevation in price assumed, ΔQ is the corresponding percentage reduction in quantity, and M is the market size. ΔQ is calculated from the price elasticity of demand formula as follows: ΔQ = ΔP×ε, where ε denotes the price elasticity. This formula assumes a curved, constant elasticity, demand curve, unlike the straight-line one used for convenience in Figure 2.

188. The results in Table 4 indicate that the sizes of both the allocative efficiency losses and the wealth transfers are quite significant for all but very small post-merger price increases. The assumed demand price elasticity value of –1.0 means that there is an upper limit on the prospective price increase—that determined by the level of the monopoly price—of 7.2%. With a price increase of that magnitude, the allocative loss would be $681,000, and the wealth transfer would be $709,000. When the price elasticity is assumed to be –0.5, the maximum price increase would be very much larger (assuming that the demand curve remained linear).

189. As already noted, the wealth transfers are not considered directly to be welfare losses, but they do provide margins which could be absorbed by the production inefficiencies discussed below.

190. In addition, the model does not make allowance for the provision of ski school activities, which the Applicant has acknowledged is a second area of the combined entity's activities that might be susceptible to dominance. This activity yields revenues of about [ ]% of those of the ski field operations activity. Although the Commission has not conducted a separate market analysis of ski school activities, the potential for detriments to arise in that area has to be built into estimates of the overall detriments.

Conclusion on Allocative Inefficiency

191. Given the uncertainties inherent in making forecasts of the kind involved here, the Commission prefers to attempt to specify a range within which the actual outcome is likely to occur, rather than to fasten upon a precise figure. In the light of the above discussion, and with the information currently to hand, the Commission has reached the preliminary conclusion that the loss of allocative inefficiency in the North Island market for downhill skiing and snowboarding services would be likely to be in the range between $100,000 and $1,000,000.

Question:

8. The Commission seeks the views of parties on the potential for losses of allocative efficiency to arise from the proposed acquisition in the relevant market. This includes evidence on the price sensitivity of skiers (price elasticity of demand), the magnitude of possible price increases post-merger, and the marginal cost per skier-day. Comments on any of the points raised above, and any other relevant points, are sought.

Productive Inefficiency

Introduction

192. A producer that enjoys a dominant position in a market is normally considered to lack the competitive pressures to remain efficient in production, and to produce at minimum cost. Organisational slack may creep into its operations, bureaucracy may expand, principle-agent problems may arise, salaries may become inflated, and waste may occur, because a satisfactory level of profit is assured even when the firm is less than fully efficient. As a result, costs in general may increase. The increase in costs is a measure of the value of the resources being wasted, which in turn indicates the value of the output foregone by the economy as a whole from those resources not being

employed productively elsewhere. It is this loss of output, measured by the higher costs, that is the social loss arising from an increase in productive inefficiency.

The Applicant's Claims

193. The NZIER considers that as the combined entity would continue to operate to a significant extent in competitive markets (i.e., involving extended stay skiers), and as there would be very few inputs that would be devoted only to the non-competitive part of the business, the scope for productive inefficiency losses to arise would be very limited. Also, it maintains that many parts of the business that provide complementary services associated with skiing would continue to face competition from alternative sources of supply, so that any losses would be limited to those parts of the business related to ski field activities where competitive pressures would be affected by the proposed acquisition. The NZIER also argues that in a commercial sense, the Applicant is competing more broadly for the discretionary spending of consumers with a range of other suppliers outside of the skiing industry, and that any inefficiency resulting in higher prices or reduced services would not be tolerated by customers.

194. Against this background, the NZIER argues that the lines of business which might be susceptible to productive inefficiency would be those in the revenue categories "ski field operations" and "ski school". The two have a combined "base year" (2000) revenue of $[ ] for the two fields, which comprises [ ]% of total revenues of $[ ]. All other revenue categories are considered to continue to face competition post-acquisition. The combined base year cash costs (i.e., excluding capital-related costs such as depreciation) are stated as being $[ ], of which $[ ], or [ ]%, are considered to be costs directly related to the provision of ski field services. In addition, a proportion of some other cost elements, being partly related to ski field services, were added, to bring the total to about $[ ] million. Of this total, just over $[ ] million comprised wages, with other large items being maintenance, insurance and electricity.

195. Although the NZIER believes that a loss of productive efficiency is unlikely, it argues that if some weakening of incentives to minimise costs were to arise from a narrowly-focused loss of competition, the affects would be small and limited in scope. Hence, a loss of productive efficiency is argued likely only at the lower end of a range from 0% to 3% of the relevant costs, or between $0 to $264,000 per annum.

The Commission's View

196. As indicated above, the Commission's preliminary view is that the combined entity will acquire a dominant position in the North Island skiing market as a result of the proposed acquisition, and that that position will not be constrained either by extended stay skiers or by alternative winter leisure activities to any appreciable extent. Hence, it believes that the potential loss of productive efficiency is likely to be greater than that envisaged by the NZIER. Moreover, as indicated above, the ability of the combined entity to exploit its market power in its price setting could generate relatively substantial rents. These could provide a wide scope for rent-seeking behaviour by managers and others in the combined entity, leading to the dissipation of rents through inflated costs. On the other hand, the unusual nature of the Constitution of RAL, with its objective of promoting skiing and its partial trust ownership, may conceivably act as a partial constraint on the development of productive inefficiency.

197. Prior to the opening of Turoa in about 1979, the Whakapapa ski field had a monopoly in the defined market. In the 1960s and 1970s the standard of service offered by the field was said to be "very poor". An issue is whether similar inefficiencies could emerge if the proposed acquisition were to proceed, and RAL were once more to achieve a position of dominance in the market.

198. RAL has acknowledged to the Commission that the quality of the service at the time was very poor, and attributed it to the general approach towards service provision in the New Zealand economy at the time, together with the fragmentation in the concession. There were three different ski lift operators (including RAL) on the Whakapapa field. In addition, the Tourist Hotel Corporation ran ski field catering and ski hire, while the predecessor of DOC looked after the car parking, roads, toilets and ski patrol. A feature of the operation particularly complained about at the time was that RAL shareholders were given priority on the lifts, while non-shareholders often waited in long queues.

199. When Whakapapa started to become overcrowded in the 1970s, DOC saw the opportunity for a new concession to be tendered at Turoa, and the competition from a second field was also thought to be desirable. DOC considers that service at Whakapapa improved markedly after Turoa entered the market. On the basis of this historical evidence, there thus seems to be some grounds for the belief that a combined RAL/Turoa could have a detrimental impact on efficiency.

200. The Commission agrees with the NZIER that the potential impact on costs of production inefficiency arising from market power, and hence the size of the potential detriment, can be assessed by assuming that costs might rise by a given percentage as inefficiency takes hold. However, it has to be acknowledged that some cost items, such as insurance or the DOC licence fee, are likely to be less susceptible to inefficiency than others, such as management and administration.

201. Likely efficiency effects of mergers are very difficult to predict. In a recent article on the dairy merger proposal, Professors Evans and Quigley made the following comment: "International studies suggest the absence of competition may often result in organisations having cost structures 10-20% higher than those of a firm facing vigorous competition."[16] The Commission, in its previous authorisation decisions where quantification has been attempted, has tended to assume lower rates of productive efficiency loss, although this may reflect its short to medium term perspective. Productive inefficiency is likely to rise over time as the experience of operating in a market where there is an absence of effective competition causes the combined entity's internal checks and balances, managerial efficiency and constraints to become less effective. Given the intrinsic uncertainty in making forecasts in this area, the best that can be done is to estimate a range within which the outcome may fall. The Commission customarily takes a three to five year time horizon over which to forecast possible future detriments. Given that in this case the Applicant has adopted a five year horizon for putting forward its claimed benefits, the Commission has for convenience elected to adopt a similar period for its detriments assessment.

202. For the purposes of illustration in the present case, and assuming the cost base as given, a [ ]% decrease in productive efficiency in the combined entity, as reflected by a [ ]% increase in costs, would give rise to a detriment of about $[ ] per annum, and costs

[16] Lewis Evans and Neil Quigley, "Dairy farmers face tough choices", *National Business Review*, 30 July 1999, p. 43.

would increase by the same magnitude for each further percentage point decrease, or proportion thereof.[17] In judging the size of this category of detriment, allowance would need to be made for the free rein given to rent-seeking-induced increases in costs by the significant increases in price thought possible.

Conclusion on Productive Inefficiency

203. After consideration of the above factors, and on the basis of the information received to date, the Commission has reached the tentative view that productive efficiency losses are likely to be in the range from [ ]% to [ ]% of the combined entity's relevant costs, or roughly between $264,000 and $880,000 per annum.

Question:

9. The Commission seeks the views of parties on the potential for the combined entity in a dominant position in the market to suffer from an erosion of productive efficiency over time, and of the cost areas which would be most susceptible to such inefficiency.

Dynamic Inefficiency

Introduction

204. Dynamic efficiency is concerned with the speed with which an industry adopts superior new technology and produces improved new products, the first through advances in productivity allowing costs of supply to be reduced, and the second bringing the benefit of meeting buyer wants more fully. In terms of the graphical analysis used above in Figure 1, product innovation would be reflected (all else remaining the same) in a rightward shift of the demand curve, indicating a buyer switch to the improved products of the innovating company or industry, whilst the lower costs associated with production innovation would be revealed by a downward shift in the unit cost curve.

205. Competition is generally considered to act as a stimulus to dynamic efficiency, and market power as a retardant. It is generally believed that in an industry which has a strong tendency for technological advance, the potential losses associated with market power could be greater in the longer term in respect of dynamic inefficiency than they are in respect of the static forms of inefficiency (namely, allocative and productive) considered above. This is partly because of the loss of the compounding effect of the improvements over time.

The Applicant's Claims

206. The NZIER argues that losses of dynamic efficiency have potentially less impact on firms in an industry with low rates of innovation than they do in industries with high rates of innovation. It claims that in the ski field industry, innovations are linked primarily to the development of equipment, which the combined entity would purchase from third parties. Innovation in facilities, such as are operated by the merger parties, is relatively low and tends to be driven by overseas trends. The NZIER claims that

[17] In terms of Figure 1, the development of productive inefficiency in the combined entity's operation, which is effectively the market, would be reflected by an upwards shift in the unit cost (MC = AC) curve. The combined entity's cost base would also be reduced slightly by the reduction in output associated with the expected elevation of price.

rather than reduce innovation, the proposed acquisition is likely to speed innovation, as the greater scale of the combined entity will allow greater, or swifter, investment in the capital-intensive facilities such as lifts and snow groomers needed for ski field operation.

207. The NZIER therefore contends that the potential loss of dynamic efficiency is zero.

The Commission's View

208. The Commission agrees that the technological innovation relating to the ski industry comes from the design of lifts and associated equipment such as snowmakers and groomers, which are manufactured overseas (e.g., Doppelmayr manufactures lifts and Kässbohrer groomers). These are purchased by ski field operators, with lifts being tailor-made to meet the requirements of each customer. Nonetheless, from the service point of view, much depends upon the extent to which ski fields actually take advantage of the equipment that manufacturers make available. For example, Turoa is using snowmakers for the first time this season to keep open its lower beginners' slopes.

209. On-field innovation comes through the services provided by ski field operators, although these are not so much innovations as adaptations or adoptions of known techniques. Examples include the provision of specialist facilities for snowboarders (as exemplified by Cardrona); the provision of "tubing runs" for tobogganers; streamlining services to improve efficiency; the adaptation of snow groomers to suit the conditions on the field; avalanche precautions; "the introduction of high speed chair lifts"; and the use of various techniques for "managing snow", such as making, mining and grooming.

210. Innovation could also be expected in marketing. The ski fields have a strong incentive to encourage more skiers as the marginal cost of an additional skier-day is very low when a ski field has excess capacity, as is the case with both Whakapapa and Turoa, so that most additional revenue on lift passes goes straight to contribution towards overheads (which are high) and profit. Pricing can be adapted to meet the different demand characteristics of particular distinguishable groups, such as beginners, students and the aged, or lowered generally when skiing conditions are limited in order to attract more custom. Seamless lift passes can be introduced, which skiers can use at different fields, or arrangements can be made with other fields that season passes for one can be used at the others.

211. Marketing may focus on attracting particular age groups, or groups from particular origins, and may involve joint marketing with other fields or other tourism operators. The running of ski field competitions may also generate interest in the sport. Because there is a surplus of airline capacity on the trans-Tasman route to Auckland during the winter, the encouragement of winter holidays is an attractive proposition for tour operators. Ski fields also have opportunities to open in the summer period to provide services to summer visitors, such as sightseeing, the alpine experience, guided trips to the crater lake, the café, and the chairlifts. RAL has operated a summer programme since 1987.

212. The skiing industry as a whole could perhaps be characterised as exhibiting a moderate level of dynamism in terms of advances in technology (in terms of the rate of adoption of such advances made external to the ski field operators), and moderate levels in terms of products. The North Island operators appear not to spend any funds on research and development, but a significant sum—about $[ ], or 2.6% of revenues—on marketing activities, and significant sums on investments from time to time on extending and

improving facilities. This balance reflects the preceding discussion. Innovation in ski field operation is most likely in products, pricing and marketing.

213. To gain some idea of the potential magnitude of any losses of dynamic efficiency through a decline in product innovation from the acquisition of dominance in the relevant market, and of the factors that may influence it, a simplified economic model is utilised. Figure 3 (at para 340) represents the market in question, showing the stylised demand and cost conditions for the combined entity (see “Public Benefits” section below). It is assumed that the market is for products that are differentiated to some degree, and that therefore are susceptible to further innovation that would enhance demand.

214. For both the counterfactual and the post-acquisition scenarios the price is assumed to be set at P_1 at the level of unit cost (this ignores the monopoly pricing issue discussed earlier). The demand curve D_1 represents both the current level of demand, and the demand in the future post-acquisition situation when the prospective product innovation fails to materialise. The demand curve D_2 shows future demand in the counterfactual, it having shifted rightward because of the increase in demand encouraged by continuing innovation in the competitive market. The resulting detriment to skiers resulting from the assumed elimination of innovation by the proposed acquisition would be the increase in consumers and producers surpluses foregone, represented by the irregularly shaped area EFBHGA.[18]

215. The size of the lost surplus in the model depends upon various factors: the initial values of price, quantity and marginal cost; the size of the foregone rightward shift in the demand curve; and the price sensitivity of the demand curve. The average lift pass price of $[ ] and quantity of 425,000 skier-days, as used above, can be employed again here, as can the estimated price elasticity of demand values of –1.0 and –0.5. For the purposes of illustration, it is assumed that the horizontal rightward shift in demand is either 0.5%, 1%, or 1.5% of current quantity. On the basis of these assumptions, Table 5 shows the corresponding estimates of loss of product innovation.

TABLE 5
Estimates of Potential Losses of Dynamic Efficiency

Assumed Demand Increase	**Price Elasticity of Demand**	
	-1.0	**-0.5**
0.5%	$99,000	$152,000
1.0%	$197,000	$304,000
1.5%	$296,000	$457,000

[18] Consumers and producers surpluses would be CFBH in the counterfactual, and CEAG with the acquisition. The acquisition thus results in the loss of the EFBHGA portion. Skier-days between 0 and Q_1 would lose the benefit from the enhanced service, while additional skier-days between Q_1 and Q_2 would not be skied at all. This approach assumes that the skiers in the region between Q_1 and Q_2 remain in other activities outside of skiing in which they are marginal participants with consumers’ surplus of zero. In Figure 3 it is also assumed for simplicity that dominance eliminates product innovation, whereas it could have the effect only of reducing it.

Conclusion on Dynamic Efficiency

216. The Commission reiterates that predictions on loss of dynamic efficiency are particularly difficult to make, and hence recognises that a relatively wide forecast range is necessary. To put the demand shifts foregone postulated in Table 5 into perspective, RAL has estimated that over the period 1975-95 the underlying growth trend in skier-days was about 2 to 2½% per annum. There may also be costs involved in making product innovations, such as marketing and promotional costs, which would be saved if innovation were to shrink, and these would need to be netted off from the estimated losses. A further difficulty is that the upper portions of the demand curves, which play a part in determining the size of the detriment, are typically not well defined.

217. In the light of all of these factors, together with its preliminary estimates, the Commission has formed the preliminary view that the potential loss of dynamic efficiency arising from the proposed acquisition is likely to be relatively moderate. The Commission's best estimate at this stage is that dynamic inefficiency could fall somewhere in the range between $100,000 and $500,000 per annum.

Question:

10. The Commission seeks the views of interested parties on the potential for dynamic efficiency in the skiing industry, and the extent to which that innovation might be eroded by dominance in the market, relative to the counterfactual.

Product Quality

Introduction

218. It is believed that product or service quality may suffer under monopoly, when the sole firm's market is assured as buyers have no other suppliers to which they may turn. The analysis of product quality has to be treated with care, however, so as to avoid the potential for double counting with other detriments.

219. In the analysis of allocative inefficiency it was assumed that product quality remained constant when the price was increased. In the analysis of dynamic inefficiency, it was argued that dominance would slow progress in the development of new and improved products and services, relative to the counterfactual. Here the argument is that product quality may deteriorate below current levels if the business acquisition were to proceed. This would be expected to be reflected in a leftward shift of the demand curve relative to the counterfactual, as consumers chose to buy less of the less attractive product. The impact of this could be measured in principle as the loss in consumer surplus, using welfare analysis similar to that employed for assessing dynamic inefficiency.

The Applicant's Claim

220. The Applicant believes that the combined entity would be constrained by demand-side factors to preserve product quality. Any reduction in the quality of the services or facilities offered would lead skiers in significant numbers to ski elsewhere, to ski on a less frequent basis, or not to ski at all. As it would not be able to discriminate between "captive" short stay and non-captive extended stay skiers in terms of product quality, the competitive side of its business would cause product quality to be maintained.

221. Hence, the amount of detriment from loss of product quality is assessed as zero.

The Commission's View

222. The Commission has already stated its view on the competition implications of the proposed acquisition. Hence, the erosion of product quality is a real possibility. Poor service quality was a feature of the operations at Whakapapa in the 1960s and 1970s, which skiers of that era still remember to this day. While this may have been substantially outside of RAL's control at the time because of the fragmentation of the concessions, it appears from anecdotal evidence that the entry of Turoa, and the competition it offered, also helped to remedy poor service quality.

223. Evidence on recent service quality is provided by a questionnaire survey of a sample of Whakapapa skiers conducted on behalf of RAL in 1995 by CM Research, following an earlier study in 1992. The later study found that while consumers perceived staff at Whakapapa as performing well, there were a number of areas where a relatively big gap emerged between what consumers wanted and what they got. This applied most markedly in areas such as the following: value for money in the cafés; availability of seating in the cafés; length of lift queues; the time taken to get rental equipment; and the reliability of snow reports. In part these difficulties probably reflect the difficulty of catering for wide variations in skier numbers, especially between weekends and weekdays, and the cost of expanding facilities to cater only for peak demand. Lift queues are also likely to develop when demand is brisk as the skiing down the slopes is quicker than the lift ride back up.

224. The previous comments suggest that if apparent product quality problems can arise even in a competitive market, they are all the more likely in a market where competition is largely absent.

225. The Commission has also been told that in the early 1980s, Coronet Peak ski field was regarded as providing a poor level of service. When competition emerged from the entry of Cardrona in the same district, service levels and management practices at Coronet Peak are said to have improved significantly. In recent times, developments at one have been quickly copied by the other, with each fearing a loss of custom should it lag behind. Treble Cone has also been drawn into the competition over facilities. Developments include snow making/grooming, snowboarding facilities, high speed lifts, child care centres, and beginner "magic carpet" lifts.

Conclusion on Loss of Product Quality

226. This detriment is difficult to measure, and care must be taken to avoid double-counting with other assessed detriments. The Commission's preliminary view is that the detriment from the loss of product quality is likely to fall within the range between $300,000 and $1,000,000.

Conclusion on Detriments

227. The Applicant has argued that the scope for detriments through efficiency losses would be limited to the range of $0-$264,000, and that from a loss of productive efficiency only.

228. The Commission has reached the preliminary view, based on the information currently before it, that the potential detriments from allocative inefficiency, productive inefficiency, dynamic inefficiency, and loss of product quality would each be likely to be moderately large, although their actual magnitudes are clouded in uncertainty. These preliminary estimates are summarised and aggregated in Table 6.

TABLE 6
Summary of Preliminary Estimates of Annual Detriments

Category	Range	
	$	$
Allocative inefficiency	$100,000	$1,000,000
Productive inefficiency	$264,000	$880,000
Dynamic inefficiency	$100,000	$500,000
Loss of product quality	$300,000	$1,000,000
TOTALS	$764,000	$3,380,000

229. Overall, the Commission's preliminary view is that, as Table 6 indicates, the detriments from the proposed acquisition would be likely to fall in the range between about $764,000 and about $3,380,000 per annum. These are the magnitudes of the annual detriments that the Commission considers are likely to eventuate by the end of the five year time horizon being used to evaluate this Application.

PUBLIC BENEFITS

Introduction

230. The Guidelines set out a number of important general principles in assessing public benefits. These include:

i. the efficiency and other gains which constitute public benefits may include both tangible and intangible benefits;
ii. public benefits must be net gains in economic and/or social terms. Any transfer or redistribution of wealth from one person or group in New Zealand to another should be ignored;
iii. benefits must be measured by reference to net gains, rather than by reference to changes in inputs or outputs on their own;
iv. benefits should not be double-counted;
v. benefits (and detriments) should be measured against an appropriate counterfactual, a "with" and "without" comparison;
vi. there must be a clear line of causality between the merger proceeding and the consequent benefits.

231. In relation to the current Application, it is important to emphasise the Commission's view that the benefits (and the detriments) must be shown to result from the proposal. If the benefit (or detriment) could have occurred in the absence of what is being proposed, it cannot be said to result from the proposal, and would not therefore be relevant.

232. This approach was agreed to by the High Court in *Fisher & Paykel Ltd v CC* [1990] 2 NZLR 731, 741 when it said:

> "…if it can be shown that the same benefits can be produced by a less restrictive alternative, then the Commission should be loath to grant the privilege of authorisation to a restrictive trade practice otherwise proscribed by the Act."

233. In addition, the onus of proof is on the Applicant to show that public benefits outweigh the detriment caused by the acquisition. This view was expressed in *Goodman Fielder/Wattie Industries Ltd* (1987) 1 NZBLC (Commission) 104,108, 104,148.

Claimed Public Benefits and Forecast Period

234. RAL claim that there will be two main sources of public benefits flowing from the proposed acquisition. The first relates to cost savings. RAL have indicated that, should the proposed acquisition proceed, a number of one-off and ongoing reductions in costs would be available, for example by removing areas of duplication. These cost savings are measured against the costs that would be incurred by the two ski fields under separate ownership.

235. The second source of public benefit claimed by RAL is an increase in output, represented by skier-days. RAL claim that this increase would not be available under separate ownership of the Whakapapa and Turoa ski fields. These benefits are measured against a baseline number of skier-days at the two ski fields if they were to remain independent. According to RAL, the additional costs associated with this increase in output have been taken into account in the Application.

236. The total benefits claimed by the Applicant are summarised in Table 7. The Table shows that the benefits amount to just under $[ ] in the first year, rising to $[ ] by 2005.

TABLE 7
Claimed Benefits

	2001	2002	2003	2004	2005
Operating cost savings	$[ ]	$[ ]	$[ ]	$[ ]	$[ ]
Capital cost savings	[ ]				
Increased output (net)	[ ]	[ ]	[ ]	[ ]	[ ]
Regional benefits	[ ]	[ ]	[ ]	[ ]	[ ]
Total	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**

237. RAL has adopted a five-year planning horizon over which the benefits of cost savings and increased output are estimated.

Cost Savings

238. The estimated cost savings relate to one-off savings in capital expenditure and ongoing savings in operating expenditure. The claimed capital expenditure savings of $[ ] arise in the first year (2001) only, while the savings in operating expenditure recur over the five-year horizon.

Savings in Capital Expenditure

i) Redeployment of capital assets across the two fields (snow groomers):

The Applicant's Claim

239. According to RAL, the proposed acquisition will result in more efficient utilisation of the existing capital assets of each ski field. TSR currently owns two snow groomers and leases a further two, and this has resulted in surplus grooming capacity at the Turoa ski field. The leases on the two snow groomers expire in July 2003.

240. RAL states that Whakapapa requires an additional groomer for the 2001 season, which would cost $[ ] to purchase. If the two fields were to be merged, RAL intends to introduce an additional shift at Turoa for grooming work, and this will release one of the groomers which will be transferred to Whakapapa. The Applicant claims a one-off saving in capital expenditure in 2001 amounting to $[ ].

The Commission's View

241. It appears that this claimed saving in capital outlays arising from redeployment of snow grooming capacity is, in fact, based on a deferral of capital expenditure. For example, when the leases expire in July 2003, either a new groomer would have to be purchased, or the leases renewed. These deferred costs do not appear to have been taken into account by the Applicant. Furthermore, it is unclear whether the Applicant has taken into consideration the additional costs associated with the extra shift at Turoa.

242. More significantly, the claim can only be accepted if it is shown that similar savings cannot be attained in the absence of the acquisition. At this stage, the Commission is not convinced that the claimed cost savings in this area depend exclusively on the proposed acquisition proceeding. An independent owner of Turoa could introduce the extra snow grooming shift which would allow it to sell one of the two snow groomers currently owned by the ski field. This suggests that the claimed savings may be available under the counterfactual.

243. The Commission has therefore decided at this stage to place no weight on the claimed cost saving.

ii) Rationalisation of maintenance bases:

The Applicant's Claim

244. Both the fields currently have their own off-mountain maintenance bases; TSR's base is located in Ohakune, while RAL's base is in National Park. The Applicant proposes to sell one of the bases, probably the National Park base, for a one-off gain of $[ ].

245. Most lift maintenance work appears to be done on the mountain. The off-mountain maintenance facilities of both ski field operators are used for servicing work on snow groomers and other equipment which cannot be undertaken at the ski fields. In such cases, the equipment is loaded onto a truck and taken down to the base. Both RAL and TSR staff have noted that the main cost of this transportation is incurred in the loading and offloading of the trucks, and that the distance travelled is a relatively minor cost determinant. The Applicant has stated that the ongoing savings from running a single base, for example in terms of property insurance and rates, would offset the small additional costs of servicing one field from a base that is slightly further away than its existing base. However, no evidence has been submitted to the Commission at this stage in support of this claim.

The Commission's View

246. The claimed one-off saving of $[ ] realised through the sale of one of the maintenance bases appears to be reasonable. This figure is based on the Government Valuation of the capital and land value of one of the RAL properties in National Park[19].

247. At this stage the Commission has decided to accept a figure of $140,000 arising from the disposal of a maintenance base under the proposed acquisition.

iii) Event management equipment:

The Applicant's Claim

248. This equipment relates largely to the holding of ski and snowboard races, which require specialised timing equipment. According to the Application, [

] with further savings in the future.

249. TSR staff said that a full set of race timing equipment would cost $15,000-20,000, and that while each field has a set, a single operator of the two fields could schedule events in a way which requires the use of only one set. The timing gear is easily transportable from one field to the other.

The Commission's View

250. Under the counterfactual of separate ownership, and assuming that each field would continue to host race and other events, each ski field would require its own set of equipment. The Commission has provisionally accepted a cost saving of $15,000 for 2001.

iv) Maintenance equipment:

The Applicant's Claim

251. The Applicant claims that "(o)ver the next few seasons, the duplication between the two fields can be rationalised by delaying further purchases, and so a saving of approximately $[ ] can be achieved. Ongoing savings can be achieved by only having one set of spares."[20]

252. These savings appear to be possible through a rationalisation of inventories, for example of electrical and mechanical parts for ski lifts. Currently each ski field must tie capital up in an inventory of specialist spare parts for lifts and other ski field equipment. It is claimed that a single operator would be able to eliminate some of this duplication.

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[19] According to the RAL 1999 Annual Report, the last valuation of RAL's two properties at National Park was undertaken by Valuation New Zealand in 1997. This valuation was $[ ] for the two properties. However, this figure only applies to land value.

[20] Paragraph 34.2(c), Application.

The Commission's View

253. According to the Application, some of this claimed benefit relates to a deferral of expenditure, and to the extent that it does, current savings will to some extent be offset by future purchases. This will have the effect of reducing the net benefit compared to the counterfactual, in a way similar to that outlined above in relation to the redeployment of snow groomers across the two fields.

254. As a result, the Commission has provisionally accepted a cost saving of $10,000 for 2001.

Question:

11. The Commission seeks comment on the magnitude and likelihood of any savings in capital costs as a result of the proposed acquisition.

Savings in Operating Expenditure:

i) Insurance

The Applicant's View

255. RAL claims that the proposed acquisition would result in a reduction in insurance premiums for the combined entity compared to the premiums attached to each field under separate ownership. This saving arises because "(m)ost of the premium is for specialised volcanic cover which insurance underwriters will not offer in parcels below a certain size. As a result, both the Applicant and TSR have had to purchase insurance at this "parcel" rate."[21]

256. RAL has provided a letter from insurance brokers, Willis Corroon Ltd, confirming that the level of savings for the combined entity would be $[ ] (Appendix 18 of the Application). The Applicant has said that an additional $[ ] would be saved through a reduction in brokerage charges, giving a total annual saving of $[ ].

The Commission's View

257. In light of the evidence from Willis Corroon, these savings appear to be reasonable. It appears that the same level of cover could be obtained by fewer inputs, resulting in a genuine net benefit compared to separate ownership and the corresponding separate insurance policies. The Commission has therefore provisionally accepted a combined cost saving of $192,000 p.a.

ii) Management and directors

The Applicant's View

258. While "there will be limited opportunities for on-site staff savings … there will be considerable savings at management level, as only one Board of Directors and one

[21] Paragraph 34.2(b), Application.

general manager will be required."[22]. In Appendix 16 of the Application, the Applicant projects that savings for 2001 in Board Expenses and Director Fees will amount to $[ ]; and savings from unified finance and management functions will amount to $[ ].

259. The Applicant accepts that there would be limited opportunities for a merged operator to make savings in relation to on-mountain staff costs. A single operator of the two ski fields would require a similar number of staff to operate lifts and other facilities as would two separate operators. However, the Applicant claims that some savings will be available as a result of having a single Board and unified management of the two fields.

260. RAL has provided Base Year (2000) budgets for Board Expenses and Directors Fees at both Mt Ruapehu ski fields. These are set out in Table 8 below, along with the claimed expenses associated with the combined entity. Compared to this baseline where total expenses and fees at the two ski fields is given as $[ ], the Applicant claims that the figure for the combined entity will be $[ ]. This saving of $[ ] includes the elimination of fees previously paid to Turoa Directors $[ ]. A further saving in Turoa Board expenses $[ ] is partially offset by an increase in RAL Board Expenses $[ ] reflecting an increase in the number of Board meetings. The Applicant intends to run both fields under the existing RAL Board.

TABLE 8
Board Expenses and Director's Fees (2000)

	Whakapapa	**Turoa**	**Claimed**	**Savings**
Board Expenses	$[ ]	$[ ]	$[ ]	$[ ]
Directors Fees	0	$[ ]	0	$[ ]
	$[ ]	$[ ]	$[ ]	$[ ]

<u>The Commission's View</u>

261. The TSR annual report for the year ended 31 October 1998 (appended to the Application) shows that the remuneration paid to Directors of TSR in 1998 amounted to $[ ], and in 1997, $[ ]. The claimed expense of $[ ] for 2000 is somewhat higher. Given the exceptional circumstances in 1998 in terms of the limited winter season, the remuneration paid for that year is ignored. However, the 1997 season at Turoa (157,500 days were skied)[23] is similar to the projected 2000 season (the Applicant's baseline assumes that 160,000 days will be skied at Turoa). In light of this, and assuming that Turoa would otherwise be operating under its own Board of Directors, a similar figure to that of 1997 seems reasonable. The Commission has therefore adopted a saving in Directors Fees of $50,000.

262. It is envisaged that the position of General Manager and Finance Manager at Turoa will be eliminated as a result of the proposed acquisition. RAL have said that the combined operation will require only one of each position. According to information provided by RAL, the removal of these two positions at Turoa will result in a saving of $[ ] p.a.

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[22] Paragraph 34.2(f), Application.
[23] See Appendix 17 of the Application (Historical Statement of Financial Performance).

An additional saving of $[ ] is claimed as a result of the merging of HR and Marketing functions.

263. While there may be some savings achieved through the consolidation of some management functions, it is not clear that the Applicant has made an allowance for the increase in workload for the existing RAL General Manager and Finance Manager. For example, it appears that two full-time Finance Manager positions have been compressed into one. Although some additional resource has been provided for management support[24], the Commission is not yet convinced that the annual saving of $[ ] can be claimed in its entirety. As a result, the Commission has provisionally accepted a figure of $100,000 for senior management savings, and $20,000 for the HR/Marketing savings.

264. In light of the proposed consolidation of management functions, the Commission has provisionally accepted aggregate cost savings in this area of $170,000 p.a.

iii) Administration

<u>The Applicant's View</u>

265. The claimed savings in this area relate to the removal of duplication in a number of areas. Compared to the counterfactual of two separate operators, RAL claim that audit fees will be reduced by $[ ] p.a. (as only one company will be audited rather than two); secretarial and accounting fees will be reduced by $[ ] p.a. (as there will be only one company secretary, and RAL uses in-house accounting services); and subscription fees will be reduced by $[ ] p.a. (as only one company subscription will be required). Some additional savings in wage costs are claimed in relation to some consolidation in rental, ski workshop, and other services. The total claimed savings in this area amount to $[ ] p.a.

<u>The Commission's View</u>

266. A number of these cost savings are relatively minor, and generally appear to be reasonable in light of the limited physical consolidation being proposed by the Applicant. However, the figures in relation to accounting services appear to be based on the assumption that the accounting staff at RAL are able to deal with the Turoa operations within existing budgets. The Commission notes that the Applicant's expenditure projections do not allow for additional resources in the "Finance & Admin" category. To the extent that additional resources will have to be employed in this area to cope with the additional workload arising from the combined operation, the net cost savings will be diminished. As a result, the Commission has provisionally discounted some of the claimed cost savings, and has accepted a figure of $27,000.

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[24] The Applicant has informed the Commission that of the $[ ] committed by Turoa to HR and Finance and Admin support, only $[ ] has been claimed. The Applicant has committed the difference of $[ ] to additional management support for the combined operation.

iv) Purchasing power

<u>The Applicant's View</u>

267. In response to a request for some further clarification of these savings, the Applicant has informed the Commission that savings of around $[ ] would be available to the combined operation through joint management of food and beverages, and retail products. Specifically, "seasonal contract negotiations and purchasing for these activities (would be) principally handled from one field rather than two."[25]

<u>The Commission's View</u>

268. RAL has noted that these savings relate to wage costs rather than any discounts the combined entity may be able to extract from suppliers as a result of enhanced purchasing power. Such discounts, to the extent that they are given by domestic suppliers, may be viewed as transfers, and in recognition of this, the Applicant has not factored them into the claimed savings.

269. The Commission has provisionally accepted a cost saving of $12,000 p.a.

Question:
12. The Commission seeks comment on the magnitude and likelihood of any savings in operating costs as a result of the proposed acquisition.

[25] Email received from RAL (16 August 2000) in response to Commission request for further information.

TABLE 9
Summary Assessment of Cost Savings

	2001	**2002**	**2003**	**2004**	**2005**
Capital savings ($):					
Redeployment	0	0	0	0	0
Maintenance base	140,000	0	0	0	0
Event mgmt equipment	15,000	0	0	0	0
Maintenance equipment	10,000	0	0	0	0
Total capital savings:	165,000	0	0	0	0
Operating savings ($):					
Insurance	192,000	192,000	192,000	192,000	192,000
Management, directors	170,000	170,000	170,000	170,000	170,000
Administration	27,000	27,000	27,000	27,000	27,000
Purchasing power	12,000	12,000	12,000	12,000	12,000
Total operating savings:	401,000	401,000	401,000	401,000	401,000
Total savings accepted:	**566,000**	**401,000**	**401,000**	**401,000**	**401,000**
Total claimed:	[ ]	[ ]	[ ]	[ ]	[ ]

Increased Output

270. The main benefits claimed by RAL are derived from an increase in the number of skier-days that would result from the proposed acquisition. The Applicant claims that this is a genuine efficiency gain which is represented as an increase in the output of skier-days for little or no additional cost. Consideration of the claimed increase in output is broken down into two steps: first, the construction of the projections of increased skier-days (expressed in days); and second, the valuation of these additional days (expressed in dollars).

271. According to the Application[26],

> "[I]ncreased output will arise [from the merger] in the following ways:
>
> (a) providing a "one mountain" experience of skiing at Ruapehu, including:
> - seamless lift passes;
> - managing capacity, skier flows and transport;
> - linking the fields;
> - complementary development of the fields;

[26] Page 30, Application.

- marketing of both fields together;

(b) providing and marketing a ski destination that will attract international visitors;

(c) flow-through benefits to Ohakune, National Park and the surrounding region;

(d) intangible benefits, including increased enjoyment, increased overall skier numbers in other fields in New Zealand and the development of expertise in ski field operations."

272. Appendix 16 of the Application contains revenue projections for the combined fields over 2001-2005. The Applicant expects approximately an additional 50,600 domestic skier-days and an additional 2,500 international skier-days in the first year as a result of single ownership of the two fields. This represents an increase on the combined projection for the two fields in 2000 of 12.5%.

273. After 2001, the number of expected additional skier-days each season remains constant at 4,820. These projections are set out in Table 10 below.

274. The Applicant has presented its projections of additional skier-days over 2001 to 2005 against a baseline for the year 2000. The Applicant's baseline is an expected 425,000 skier-days for Whakapapa and Turoa combined in 2000. This can be broken down into the number of days skied by season pass holders (193,000) and the number skied by day pass holders (232,000). The Applicant assumes that season pass skier-days will increase by 19%, and day pass skier-days by 6%, as a result of the proposed acquisition in the first year. In each of the following years, the increase in the total number of domestic skier-days at the combined fields is assumed to increase by a constant 2,320, while the increase in the number of days skied by international visitors is assumed to increase by 2,500 days each season. These growth projections are attributed by the Applicant to the proposed acquisition, and are set out in Table 10.

TABLE 10
Claimed Incremental Skier-Days, 2001-2005

	2000 baseline	**2001**	**2002**	**2003**	**2004**	**2005**
Season pass skier-days	193,000	36,662				
Day pass skier-days	232,000	13,922	2,320	2,320	2,320	2,320
International skier-days		2,500	2,500	2,500	2,500	2,500
Annual Increment (due to proposed acquisition)		**53,085**	**4,820**	**4,820**	**4,820**	**4,820**
Total Skier-Days	425,000	478,085	482,905	487,725	492,545	497,365

275. The baseline figure of 425,000 is greater than the average number of skier-days at the two fields over the period 1992-99. Over that period, the average number of actual days skied was 309,512 days per season. The Applicant has made a number of "adjustments" for volcanic activity in the 1995 and 1996 seasons, which raise the average to 355,140.

276. The baseline used by the Applicant is roughly equivalent to the average number of skier-days at the two fields in the early 1990s: in 1992, just over 422,000 days were skied at Turoa and Whakapapa combined; for 1993, the figure was 435,280; and for

1994, 451,690. The 1995 and 1996 seasons were interrupted, severely in the case of the latter, by volcanic activity: 342,320 skier-days were recorded at the two fields in 1995, and only 147,650 days in 1996 (the Applicant adjusted these figures to 420,000 and 435,000 respectively). The last three seasons have all been relatively poor, particularly 1998 when a total of only 59,000 skier-days were recorded.

277. The Applicant's baseline figure of 425,000 skier-days on both fields in 2000 is based on "average snow cover" (refer paragraph 93 above). The Mt Ruapehu ski fields have not had such snow cover since 1995.

278. Figures on skier-days provided by TSR show that the early 2000 ski season at Turoa was tracking slightly behind the seasons of the early 1990s. For example, by mid-July in 1993, 1994, and 1995, approximately [ ] skier-days had been recorded at Turoa. At the same stage in 2000, approximately 25,000 days had been recorded. However, by the end of July, the earlier seasons had continued steady growth towards 60,000 days, while the figure for 2000 had plateaued at about [ ] days as a result of an absence of new snow. It is too early in the season to test the Applicant's baseline assumption of 425,000 days.

279. In light of the earlier discussion regarding NIWA's views on likely snow conditions over the next five years (refer paragraph 94), the Commission provisionally accepts the Applicant's use of a baseline figure of 425,000 skier-days for the year 2000.

Increase in Days Skied by Domestic Day Pass Holders

280. As the Applicant quantifies the expected increase in output in terms of an increase in the number of days skied by domestic day pass holders, season pass holders, and international skiers, the increase in each of these categories is now considered.

<u>The Applicant's Claims</u>

281. The baseline number of domestic day pass skier-days at Mt Ruapehu is 232,000 days. As part of the claimed benefits resulting from the proposed acquisition, RAL has projected a first-year increase in this number of 6%, or 13,920 days. A further 1% annual growth has been claimed through to 2005. These increases are broken down as follows:

- the introduction of 'seamless' lift passes accounts for 4%, or 9,280 days;
- the development of a traverse linking the two fields accounts for 2%, or 4,640 days;
- the traverse will also account for further growth of 1%, or 2,320 days, each year through to 2005.

282. The introduction of seamless passes as a result of the proposed acquisition would enable pass holders to ski at both fields. RAL claims that this would enable skiers to move around the mountain in response to weather conditions. Because of different localised weather conditions around the mountain, one field can be open for skiing and the other closed. The Applicant claims that, on such days, skiers at the closed field are unlikely to switch for the day to the other field, for example due to the transaction costs of dealing with two separate organisations. However, with a seamless lift pass that provides access to both fields, such switching would be encouraged.

283. RAL has indicated that it has used data for open and closed days on the mountain for the 1994 and 1997 seasons to estimate the potential increase in days skied by day pass holders on the mountain as a result of joint ownership. The Applicant assumes that on those days where one field was closed and the other open, 50% of the skiers who would have otherwise skied at the closed field move around to the other field and ski there. For example, in 1994, there were 32 days when Turoa was closed but Whakapapa was open. The average number of skiers per day at Turoa on a weekend or during school holidays was 2,295 in 1994; while for a weekday (outside the holidays), the average number was 810 per day. Therefore, if Turoa were closed on a Saturday, while Whakapapa remained open, the Applicant believes that approximately 1,150 skiers would be encouraged by a seamless pass to move around to Whakapapa, and that this movement would not happen in the absence of the proposed acquisition.

284. Using the two seasons (1994 and 1997), the Applicant estimates that this would result in a 4% increase in total days skied at both fields over the 2000 base. Applied to the number of estimated day pass holders in 2000, this leads to the claimed increase of 9,280 days as a result of the proposed acquisition.

285. The remaining 2% (4,640 days) is attributed by RAL to the development of a physical link between the two fields through free guided traverses. Such tours would be more attractive to skiers if they had a seamless lift pass that provided them with access to both fields.

286. RAL has indicated that up to 1,000 skiers could make the guided traverse each day, and have factored in the cost of providing additional guides. The traverse is expected to take approximately 45 minutes to complete, and in conjunction with the seamless lift passes, will enable skiers to ski at both fields in one day.

287. RAL has also factored in an additional growth in day pass skier-days of 1% over each of the subsequent years. This amounts to an additional 2,320 skier-days each year between 2002 and 2005. This additional growth is based on the promotion of the guided tours linking the two ski fields.

The Commission's View

288. A number of points need to be noted on the Applicant's approach. First of all, it may be unrealistic to assume that on each day that Turoa is closed but Whakapapa is open, 50% of those skiers who would have skied at Turoa (had it been open) would move instead around to Whakapapa. From the information on skier numbers in 1994 and 1997 supplied to the Commission, it appears that on a number of days when Turoa was closed but Whakapapa remained open, Whakapapa was only operating at very limited capacity, presumably because of marginal conditions on that side of the mountain as well.

289. For example, on five of the 32 days in 1994 when Turoa was closed but Whakapapa was open, less than 100 skiers were recorded at Whakapapa. In 1997, on three of the 18 days, less than 10 skiers were recorded at Whakapapa. This suggests that on such days, conditions at Whakapapa were such that it would be unlikely that the proposed numbers being switched from the Turoa side to the Whakapapa side could be catered for. For example, on 7 July 1994, Turoa was closed but 80 skiers were at Whakapapa. This suggests that conditions at Whakapapa were marginal and only very limited facilities were available. The proposed transfer of a further 400-500 skiers may in such cases be unlikely.

290. Second, it is important to note that the Applicant's analysis at this point is in relation to day pass holders. RAL indicate that this 'closed day' effect will lead to an increase in skier-days at the mountain of 9,280 days as a result of the proposed acquisition and the consequent introduction of a seamless day pass. However, a seamless pass is likely to hold limited additional appeal for day pass skiers, as they have the choice of which field to ski at irrespective of whether the fields are jointly or independently owned. A skier who purchases a day pass can make a decision as to which field to ski early in the morning, based on widely available condition reports and weather forecasts. If skiers staying in Ohakune, for example, learn that conditions appear better at Whakapapa, they can easily travel around to Whakapapa and ski there.

291. The Applicant's claim regarding the transaction costs of dealing with two separate ski fields appears to relate to the inconvenience of hiring ski gear at field A, skiing at field B, and then having to return the rental gear to field A, necessitating an additional trip. However, the Commission believes that these transaction costs are likely to be small. Most of the equipment hired at the ski fields is done so on a day-by-day basis. Once a decision has been made to ski at a particular field, equipment can be hired from that field for the day. The transaction costs associated with the return of the rental equipment in this case are negligible.

292. Multi-day rental has an advantage in that the skier needs to go through the fitting and hiring process only once (as opposed to each morning if the gear is hired on a daily basis). However, it appears that such rental packages are widely available on a daily basis from competing outlets. Multi-day rental appears to be flexible in terms of pricing and return of equipment (for example, when the ski fields are closed, skiers can telephone their rental outlet to say they are not using the equipment for that day). The difficulties alluded to by the Applicant in returning rental equipment under the counterfactual are unlikely, in the Commission's view, to be significant.

293. In any case, the return of rental equipment hired from the other field does not appear to be an insurmountable problem for separate ownership. As of early August, RAL is about to open an office in Ohakune along with a bus service from the office to Whakapapa ski field. It appears that this service could easily be used to return RAL skis and other equipment hired by skiers who switched to Turoa.

294. In discussions with the Commission, RAL have raised the situation where a group of skiers on a pre-paid package may arrive at Whakapapa to find that the ski field is closed, while Turoa is open. In such instances, under single ownership, the group would be encouraged to move around to Turoa. The Applicant claims that under the counterfactual of separate ownership, this is less likely to happen, and therefore the additional days can be counted as a net increase as a result of the proposed acquisition.

295. The Commission is sceptical of the extent to which the proposed acquisition would enhance such movement around the mountain. Under separate ownership, it may be unlikely that RAL would actively promote its competitor on days where Whakapapa is closed but Turoa is open, and vice versa. However, on such days, there would be some benefit to RAL if the group (or individual) did move around to Turoa if that meant that they were likely to leave the mountain having had a good day skiing, rather than none at all.

296. According to para 36.18 of the Application:

> "Single ownership of the two ski fields provides other opportunities to manage the ski experience for the benefit of skiers (and thus increasing the likelihood of increased skier-days). Some examples of skier management include:

(a) encouraging skiers to use whichever field has better weather conditions on any given day through the use of on-mountain ski reports and word of mouth from ski field staff. At the moment, each field wants to attract skiers whenever it is open, regardless of whether conditions are actually better at that field;

(b) managing flows to better utilise capacity. If one field is at capacity (with the resultant longer lift queues) a single owner could encourage skiers to go to the other field (by putting on buses, through radio reports and its website)."

297. Again, these reasons are not particularly convincing. They relate to the movement of skiers from one field to the other *within a given day*. In the first instance, such efforts to move skiers from one field to another during a particular day are unlikely to be successful, due to the time taken in physically moving from one field to the other. According to information provided by the Applicant, the distance from Ohakune to Whakapapa ski field is 50 kms. In addition, the road from Ohakune up to the Turoa ski field is a further 17 kms. The journey from one field to the other is therefore likely to take at least an hour by car, and possibly longer by bus. This lost skiing time, representing 15% of a full day of skiing, is likely to deter skiers from moving to the other field, once a decision has been made to purchase a day pass.

298. The Applicant also indicates that a bus service between the two fields will be provided by a single owner. However, as noted above, the Commission understands that RAL is about to commence a bus service from its new office in Ohakune to the Whakapapa ski field. This service, and the extent to which it is successful in increasing the mobility of skiers around the mountain, needs to be considered as part of the counterfactual. This will discount the net benefits emerging from the proposed acquisition.

299. A free guiding service linking the two ski fields may result in some increase in the number of days skied by domestic day pass skiers. However, at this stage the Commission is not convinced on two points: that the increase will be of the magnitude suggested by the Applicant, and that any increase could not be achieved through a cooperative effort between two separate owners.

300. The traverse is likely to be attractive only to intermediate or advanced skiers who are already on the mountain and are reasonably confident in their ability to make the trip of 3-4 kms. The extent to which a traverse between the two fields will attract new skiers, or encourage existing skiers to ski more often, is uncertain. In addition, it is unclear as to whether snowboarders will be able to make the traverse; if it can only be undertaken by skiers, this will reduce the potential pool who will want to attempt it.

301. The Applicant has referred to the possibility of further developing the traverse into a fully groomed trail between the two fields. This would require considerable additional cost in terms of grooming and safety work, such as avalanche control over the length of the trail. The Commission understands that this would require DOC approval, and DOC has indicated that it would probably withhold such approval. As a result, both the Commission and RAL have discounted such a development.

302. In addition to questioning the size of any impact of the traverse on skier-days, the Commission also remains to be convinced that seamless passes and the traverse are dependent on the proposed acquisition taking place. If such a guided traverse were attractive to skiers, two separate owners of the ski fields would have a commercial incentive to explore avenues for the cooperative provision of such a service. This could plausibly be achieved in conjunction with a revenue-sharing arrangement which would allow skiers making the traverse to ski at both fields.

303. In light of the above concerns, the Commission has provisionally decided to discount the claimed increase in days skied by domestic day pass holders as a result of the proposed acquisition. The range of discounts adopted at this stage is 75-100%, although the Commission is currently of the view that any increase will probably be towards the lower end of the range of skier-day estimates. This reflects the Commission's scepticism over the magnitude of the claimed increase. As a matter of principle, the Commission also remains to be convinced that there is a clear nexus between the claimed increases and the proposed acquisition.

TABLE 11
Additional Skier-Days by Domestic Day Pass Skiers
(compared to baseline 2000)

	2001	**2002**	**2003**	**2004**	**2005**
Claimed	13,922	16,242	18,562	20,882	23,202
0% Accepted	0	0	0	0	0
25% Accepted	3,480	4,060	4,640	5,220	5,800

Question:
13. The Commission seeks comment on the extent to which day pass skier-days are likely to increase as a result of the proposed acquisition. In particular, views are sought on the extent to which the claimed increase in days skied by domestic day pass holders could only be achieved as a result of the proposed acquisition. Comments on the attraction to day pass skiers of a seamless lift pass and the proposed guided traverse between the two fields would be useful.

Increase in Days Skied by Season Pass Holders

The Applicant's Claims

304. The baseline number of days skied at Mt Ruapehu by domestic season pass holders is 193,000 days. RAL has projected an increase in the number of days skied by season pass holders, as a result of the proposed acquisition, of 36,662 days in 2001. This represents a 19% increase over the baseline 2000. This increase in days skied by season pass holders is broken down by the Applicant as follows:

- the introduction of 'seamless' lift passes accounts for 4%, or 7,720 days;
- the development of a traverse linking the two fields accounts for 6%, or 11,580 days;
- the ability to ski on both fields will encourage existing season pass holders to ski more often, accounting for a further 9% increase, or 17,370 days.

305. RAL claims that season passes will be more attractive as a result of holders being able to move around the mountain in response to weather conditions. Season pass holders, who would otherwise be committed to one field or the other, would be encouraged to ski on those days where one field is closed and the other open. From it's earlier

analysis of closed days on the mountain, the Applicant claims that this will translate into a 4% increase in days skied by season holders.

306. RAL also claim that the linkage of the two fields will lead to a further increase in season pass skier-days. This increase has been estimated by RAL to be approximately 11,580 days in 2001, a 6% increase over the baseline figure for 2000.

307. The final component of the 19% increase claimed by the Applicant is due to a claim that existing season pass holders will ski more days on average than they would otherwise. The reasons put forward are the same as those above, namely the access to both fields. According to additional information provided by the Applicant, RAL has assumed that existing season pass holders will increase the number of days they ski by 9% (0.64 days) on average. This translates into an additional 17,280 days in 2001.

The Commission's Views

308. The Commission accepts that a season pass which provides access to both ski fields may generate additional skier-days, although again the magnitude of any increase is subject to considerable uncertainty, as is the causal link between the increase and the proposed acquisition. The Applicant has provided some detail setting out its assumptions behind the claimed increase in skier-days.

309. In order to accept the use of the concept of a 'seamless' lift pass as a basis for claiming a benefit, it needs to be shown that the benefit could not be secured in the absence of the proposed acquisition. However, as noted earlier, the Commission is not at this stage convinced that a 'seamless' pass providing access to both ski fields could not be developed through a revenue-sharing arrangement between two separate operators of the fields. Likewise, it is plausible that the claimed 6% increase in skier-days as a result of the traverse could be achieved through the cooperative efforts of two independent owners of the two ski fields.

310. In addition, it appears that there may be some double-counting of benefits. The Applicant assumes that existing season pass holders will increase their annual skier-days by 9% on average as a result of the proposed acquisition. The reasons given for this increase also relate to the ability of skiers to move around the mountain when one field is closed, and the linking of the two fields via a guided traverse. As a result, an existing season pass holder who moves around to Whakapapa when Turoa is closed, and thus skies an additional day, appears to have been captured twice by the Applicant.

311. One further point relates to the possibility that even if the number of season pass holders increases as a result of the proposed acquisition, this may be at the expense of day pass sales. For example, if the seamless pass and the traverse do in fact make season passes more attractive, skiers who previously purchased day passes are likely to instead purchase a season pass. This will tend to reduce the net increase in skier-days as a result of the proposed acquisition.

312. As noted above, the Commission is yet to be convinced by the Applicant that these innovations would only be forthcoming as a result of the proposed acquisition. The Commission has therefore discounted the claimed increase in season pass skier-days by 75-100%. Again, the Commission has formed a preliminary view that the increase will probably be towards the lower end of the range of skier-day estimates.

TABLE 12
Additional Skier-Days by Domestic Season Pass Skiers
(compared to baseline 2000)

	2001	2002	2003	2004	2005
Claimed	36,662	36,662	36,662	36,662	36,662
0% Accepted	0	0	0	0	0
25% Accepted	9,165	9,165	9,165	9,165	9,165

Question:

14. The Commission seeks comment on the extent to which season pass holders are likely to ski more days at Mt Ruapehu as a result of the proposed acquisition. In particular, views are sought on the extent to which the claimed increase in days skied by season pass holders could only be achieved as a result of the proposed acquisition. Comments on the attraction to season pass skiers of a seamless lift pass and the proposed guided traverse between the two fields would be useful.

Increase in Days Skied by International Visitors

The Applicant's Claims

313. Presently the Mt Ruapehu ski fields attract very few skiers from overseas. According to detailed market research undertaken for the Applicant in 1995, only 3% of skiers at Whakapapa resided overseas[27]. This compares with a figure of 45% for the South Island fields (1999). The Applicant states that the main reasons why so few international skiers visit Mt Ruapehu are the lack of a "destination" and the unreliability of the weather.

314. RAL places considerable emphasis on the need to present Mt Ruapehu as a holiday destination and to focus a marketing campaign on the mountain as a whole. The Applicant estimates that the merger of the two ski fields on Mt Ruapehu would attract an additional 500 visitors from overseas in the first year, who would each ski on average five days at Mt Ruapehu. For each subsequent year, an additional 2,500 skier-days would be attracted to the mountain, reaching 12,500 days by Year 5 (2005).

315. The Applicant has based its position on a number of factors. In particular, reference is made to an interview with Mr Euan Purdy (New Zealand Tourism Board), in which Mr Purdy indicated that a sustained marketing effort could attract up to 25,000 skier-days from Australia within four to five years. In a subsequent interview with Commission staff, he expressed the view that 500 skiers would be possible in the first year; 1,000-1,500 within a couple of years after that; followed by gradual further growth. He said that an average of five days skiing per visitor seemed reasonable.

[27] Page 17, Whakapapa Research Survey, see note 1.

316. Similar comments have been made by other parties contacted as part of the Commission's investigation. A number of Australian-based tour operators have stated that the promotion of Mt Ruapehu as a whole is more likely to attract Australian visitors to the region than separate campaigns focusing on the individual ski fields. A combined Whakapapa/Turoa would provide the largest ski area in the southern hemisphere, a greater variety of terrain could be skied under a single pass, and skiers would be less susceptible to Mt Ruapehu's variable weather as they would be able to ski on either side of the mountain. While the latter two advantages could still be secured by purchasing lift passes on a day-by-day basis, ski packages often include pre-purchased passes which commit skiers to a particular field.

317. RAL also refers to an attempt with TSR to jointly market the two ski fields to attract overseas visitors. The two operators ran a joint campaign over 1993-95, which included a joint pass for overseas visitors. The campaign was run in association with the New Zealand Tourism Board and focused on the Australian market. The campaign succeeded in attracting just under 1,000 international visitors to Mt Ruapehu in 1994, although the campaign ended prematurely in 1995, primarily, according to the Applicant, due to differing levels of commitment between the two partners.

The Commission's Views

318. To be accepted as a benefit arising from the proposed acquisition, the Applicant must demonstrate that the claimed increase in the number of days skied by international skiers could not have been achieved in the absence of the proposed acquisition. In other words, if it is reasonable to expect that the same increase could be secured under the counterfactual of separate ownership, then any consequent benefit should not be included.

319. The Commission is yet to be convinced on this matter. The Applicant itself points to the success of the joint campaign conducted by the two ski fields in the early 1990s in conjunction with the NZ Tourism Board. Alan Williams, the owner of one of Australia's largest travel wholesalers (Ski-One), who was instrumental in organising that campaign, has informed the Commission that the campaign attracted approximately 600 visitors to Mt Ruapehu in 1993, with an average stay of 8-9 nights. The following year, the number of visitors increased to just under 1,000. In 1995, bookings had increased by 24% when the eruptions occurred. The subsequent volcanic activity throughout 1995 and 1996 coincided with the ending of the joint effort.

320. That joint campaign suggests that separate ski field operators are able to market Mt Ruapehu cooperatively as a ski destination, and to attract overseas visitors, without relying on single ownership. That campaign appears to have been quite successful in attracting overseas skiers to Mt Ruapehu. However, this raises the question as to whether a similar arrangement could be resurrected by two independent ski field operators.

321. According to RAL, a number of factors contributed to the collapse of the joint campaign in 1995. In addition to the eruptions, it was felt that the two partners did not share the same level of commitment; TSR at the time did not contribute fully to the arrangement. The two parties also had difficulty agreeing on the revenue-sharing formula associated with the joint pass.

322. There may be inherent tensions in a joint marketing campaign run by two independent and competing ski field operators compared to a campaign under sole ownership.

These tensions could be avoided by a campaign run by a single operator of the two fields. However, it appears that despite some apparent difficulties between RAL and TSR, the 1993-1995 campaign was successful. It is difficult to determine whether that campaign ceased as a result of the eruptions or disputes between the partners; it may have been a combination of both[28]. Nevertheless, the campaign was run on a year-by-year basis and both fields appear to have benefited.

323. The Commission has been informed by one of the other parties seeking to purchase Turoa that it would be interested in restoring such a cooperative marketing campaign with RAL, and has approached RAL to discuss options for joint promotion of the ski fields.

324. There appears to be some historical evidence in the South Island of joint marketing by independent ski fields. In the mid 1980s, 80% of Australians who came to the South Island to ski went to Mt Hutt and only 20% went to Queenstown. In response, local Queenstown leisure interests jointly funded an aggressive marketing campaign in conjunction with travel agents, targeting the Australian market. By 1995, the campaign had succeeded in reversing the earlier figures. This suggests that joint marketing can be successfully undertaken by competing commercial interests.

325. Marketing campaigns targeting overseas markets tend to be focused not just on the mountain itself, but on the region. In an interview with Commission staff, *nzski.com* (the owner of the Mt Hutt, The Remarkables, and Coronet Peak ski fields) explained that a range of different marketing programmes are employed currently. Local and regional advertising focuses on the individual ski fields. However, as the target market broadens and becomes more distant, the marketing takes on a more cooperative approach between regional partners, for example, other ski field and leisure operators and travel wholesalers. Each component contributes to a critical mass of attractions which is necessary to draw visitors from overseas.

326. In other words, a successful overseas marketing campaign will require a partnership approach in order to secure greater appeal and reach. Separate owners of the two North Island ski fields could enter into such a partnership with other local and regional interests and market towards overseas visitors. To the extent that this can happen in the absence of the proposed acquisition, the benefits claimed by the Applicant need to be discounted. The Commission therefore is not at this stage convinced of the claimed benefits of the proposed acquisition in terms of attracting additional skiers from overseas, compared to what could be achieved under separate ownership of the two ski fields.

327. A second issue relates to the question of transfers. If the proposed acquisition were successful in attracting overseas skiers to Mt Ruapehu, but those skiers would otherwise have skied in the South Island, then the gains achieved at Mt Ruapehu may be largely offset by the losses at the South Island field. The net benefit has to be assessed for New Zealand as a whole.

328. Value Tours, a major Australian tour wholesaler, has commented that some skiers attracted to Mt Ruapehu may be new to New Zealand, or may extend their visit in order to ski. For example, the North Island is likely to attract what Value Tours calls the ‘soft skier’ who travels on a winter holiday and may add in a few days skiing. However, other skiers may have otherwise skied elsewhere in New Zealand. Euan Purdy (New

[28] According to Alan Williams of Ski-One, the eruptions were the major reason behind the termination of the campaign.

Zealand Tourism Board) has expressed a similar view that in the first year at least, some of the 500 skiers from overseas would probably have otherwise skied in the South Island. While it is difficult to quantify any such transfer, it is likely that some transfer will occur, at least in the early stages of a marketing campaign.

329. In the course of the Commission's investigation, the issue of international access to the Mt Ruapehu ski fields has been raised. The perception that the lack of an international airport in the vicinity of Mt Ruapehu may inhibit any attempt to attract international skiers may not be a serious issue. There is considerable capacity and frequency of international flights into Auckland and Wellington, while flights from Australia also land at Palmerston North. During the winter period, flights into these centres have considerable spare capacity. On the other hand, Queenstown airport receives once-weekly flights from each of Brisbane and Melbourne, and twice-weekly flights from Sydney. Each flight carries approximately 110 seats. Given this limited capacity, most overseas skiers who visit Queenstown fly into Christchurch and then drive to Queenstown.

330. However, at this stage, the Commission is yet to be convinced of the claimed increase in days skied by international skiers attracted to Mt Ruapehu as a result of the proposed acquisition. This position is based on two grounds: first, that the Applicant needs to demonstrate a clear line of causality between the proposed acquisition proceeding and the claimed increase in skier-days; and second, that the claimed increase in skier-days represents a net increase to New Zealand, rather than a transfer away from another ski field.

331. The Commission has considered placing no weight on the claimed increase in international skier-days, as it believes that commercial incentives are likely to be such that the same effect could be achieved through cooperative efforts of the two ski fields under separate ownership. However, the Commission has decided to provisionally discount the claimed increases by a range of 75-100%, noting that the increase is likely to be towards the lower end of the range of estimates.

TABLE 13
Additional Skier-Days by International Skiers

	2001	**2002**	**2003**	**2004**	**2005**
Claimed	2,500	5,000	7,500	10,000	12,500
0% Accepted	0	0	0	0	0
25% Accepted	625	1,250	1,875	2,500	3,125

Question:
15. The Commission seeks comment on the extent to which the proposed acquisition is likely to attract overseas skiers to Mt Ruapehu. In particular, views are sought on the extent to which international skiers could be attracted to Mt Ruapehu in the absence of the proposed acquisition, for example by a joint effort by two separate ski field operators. Further comment is sought on the extent to which any international skier-days at Mt Ruapehu would likely be new to New Zealand or merely represent a transfer from other New Zealand destinations. The Commission also seeks comments on the importance of the "destination" concept and the accessibility of the Mt Ruapehu ski fields for international visitors.

Summary of Increased Output

332. The range of increases in skier-days discussed above are summarised in Table 14 below. The Table includes the increases claimed by the Applicant along with the ranges provisionally adopted by the Commission.

TABLE 14
Increase in Skier-Days
(compared to Baseline 2000)

	2001	**2002**	**2003**	**2004**	**2005**
Domestic	0 – 12,645	0 – 13,225	0 – 13,805	0 – 14,385	0 – 14,965
International	0 – 625	0 – 1,250	0 – 1,875	0 – 2,500	0 – 3,125
Total Accepted	**0 – 13,270**	**0 – 14,475**	**0 – 15,680**	**0 – 16,885**	**0 – 18,090**
Claimed	53,085	57,904	62,724	67,544	72,364

Valuation of Skier-Days

The Applicant's Claims

333. The Applicant notes that the increased output generated by the proposed acquisition is generally measured in terms of the increased skier-days. In converting the increased skier-days into dollar terms, the Applicant uses the average cost of a day's skiing, including the average price of a ski pass and the average expenditure on food and beverages (and related on-mountain services). The average revenue realised by the sale of a ski pass across all skiers is given as $[ ], excluding GST, while the average cost of the other items is $[ ]. "On this basis the dollar value of an additional skier day is $[ ]."[29] The Applicant has subsequently made a slight adjustment to this figure in light of updated estimates of expenditure on other on-mountain services.

334. The Applicant then applies the values to the projected increase in days skied by day pass and season pass holders. According to the Applicant, this reflects the fact that,

[29] Page 31, Application.

although a season pass holder skiing an additional day does not generate any additional lift revenue for the operator, there is nevertheless value attached to that additional day of skiing, and this value needs to be recognised.

335. The Applicant acknowledges that there will be some additional costs involved in servicing the increased skier-days, although these costs are unlikely to be significant. The operation of a ski field incurs a high level of fixed costs. For example, according to the RAL annual report for the year ending 30 April 1999, the lift and building infrastructure at Whakapapa had a book value of $[ ] and a historic cost of just over $[ ]. Operating expenses such as staff required to operate lifts are not particularly sensitive to variations in skier numbers.

336. Furthermore, as discussed earlier, the Mt Ruapehu ski fields appear to be operating with considerable excess capacity. This suggests that the marginal cost of servicing a skier day will be quite small, and as a result, the value generated by such a day incurs little additional cost. In other words, the increase in output (additional skier-days) can be achieved with little increase in inputs, and so the output increase is in large part an efficiency gain.

337. The Applicant does make an adjustment for the additional costs that are associated with an increase in skier-days. In particular, the cost of additional goods (food, beverages etc) sold will need to be subtracted in order to express the benefit in net terms. For example, a $100 increase in food sales (output) can only be assessed as a net benefit once the additional cost (input) of servicing those additional sales is removed. Another example is the cost associated with the guiding service linking the two ski fields.

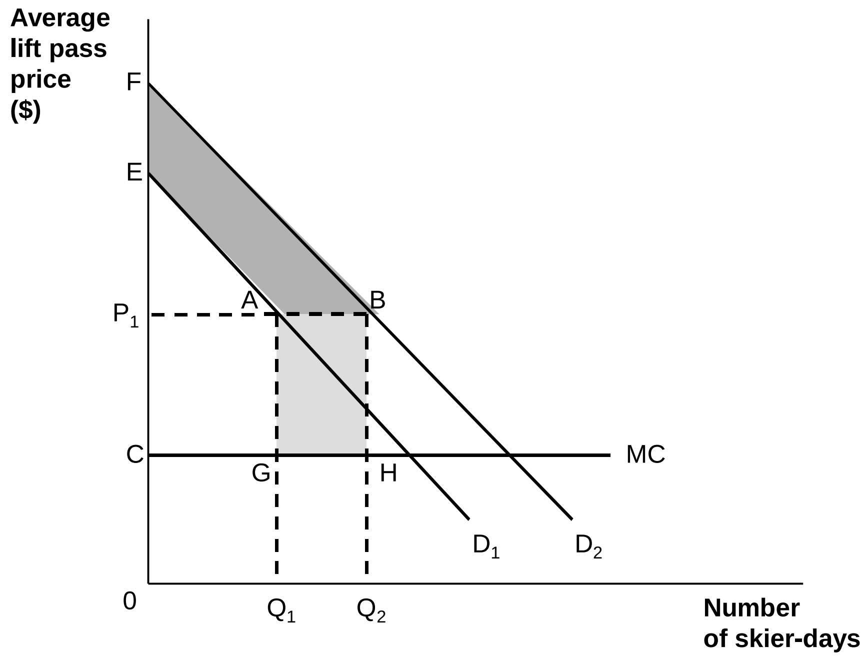
338. Accordingly, the Applicant has subtracted an estimate of the increased costs associated with the increase in skier-days. This correction amounts to $[ ] for 2001, rising to $[ ] in 2005.

The Commission's Views

339. The Commission believes that the Applicant's approach to the valuation of additional skier-days, while showing the extra financial surplus likely to be generated by the combined entity, does not appropriately measure their economic or social value, which is the value needed in the Application of the public benefit test. In estimating these prospective social values, distinctions have to be made between domestic and international skiers, and between benefits claimed for the skiing market and those claimed for complementary products markets.

340. The appropriate valuations can be explained using Figure 3, which shows the position of the North Island skiing market before and after the proposed acquisition. The average lift pass price is assumed to remain at P_1 throughout, and marginal cost is shown by the horizontal line MC. Before the acquisition the market demand is at D_1, but this shifts rightward to D_2 to reflect the Applicant's claim that skier-days will increase as a result of the proposed acquisition.

FIGURE 3



341. The Applicant's benefit claim with respect to the increase in demand is measured as the difference between price and marginal cost for each skier-day, multiplied by the number of additional skier-days. In terms of Figure 3, this total is represented geometrically by the lightly shaded area ABHG; it shows the difference between the extra amount paid by the additional skier-days for lift passes (and hence extra revenues to the combined entity) of ABQ_2Q_1, and the extra costs incurred by the ski field in accommodating those extra skier-days of GHQ_2Q_1. While the Commissions considers this to be appropriate for international skier-days (see below), the correct approach for domestic skier-days is somewhat different.

Domestic Skier-Days

342. Assuming that Figure 3 relates to domestic skiers only, the benefit stemming from the increase in skier-days for domestic skiers is larger than the area ABHG claimed by the Applicant. This analysis assumes that short-run marginal cost is the correct cost measure, as discussed earlier. Prior to the demand increase, the total net welfare generated in the market is represented by the area CEAG[30] (of which CP_1AG is surplus accruing to the business by it setting a price higher than marginal cost). After the demand increase, total net welfare has expanded to CFBH. The demand shift thus leads to an increase of net welfare equal to the amount claimed by the Applicant of ABGH, plus an additional amount represented by the heavily shaded area EFBA. This is the benefit to domestic skiers from any assumed increase in demand induced by the business acquisition.[31]

[30] This area is equal to the area of gross consumer welfare, $OEAQ_1$, less the cost of supply, $OCGQ_1$.

[31] In principle, the increased surplus generated for those skier-days already skied—those between 0 and Q_1—is measured as described. For those additional skier-days Q_1 and Q_2 the corresponding triangular part of the shaded area EFBA is the appropriate measure of benefit only on the assumption that those skiers are drawn from other activities in which they are marginal participants with consumers' surplus of zero.

343. The size of the expansion of surplus will be sensitive to a number of factors, including the initial values of the price, quantity, and marginal cost; the size of the rightward shift in the demand curve as a result of the proposed acquisition; and the price elasticity of demand. The average lift pass price of $[ ] and the baseline number of 425,000 skier-days at Mt Ruapehu have been used here. The Commission has also derived an estimate of the marginal cost of a skier day (excluding complementary services) of $[ ], based on expenditure forecasts provided by the Applicant.

344. The Commission has adopted a range for the increase in domestic skier-days as a result of the proposed acquisition. This range is 0-14,965 days per year by the end of the five year period. Therefore, the lower bound results in no increase in demand as a result of the proposed acquisition, and so the lower bound is $0. The upper bound of 14,965 days results in a rightward shift in the demand curve to the extent that the final quantity is 439,965 days (the baseline plus 14,965). Following the earlier section on detriments, the valuation of benefits is run under two values for the price elasticity of demand, –0.5 and –1.0.

TABLE 15
Estimates of Annual Benefit from Increased Output
of Domestic Skier-Days by 2005

Assumed Increase in Demand (days)	**Price Elasticity of Demand**	
	-0.5	**-1.0**
0	$0	$0
14,965	$1,079,403	$699,453

345. In other words, by the end of the five year period, the annual value of the additional domestic skier-days is estimated to range from $0-1,079,403.

346. So far this appraisal of the Applicant's approach has been confined to the skiing market. However, RAL also uses a similar analysis to measure the benefit it claims stems from the consumption by the additional skier-days of other complementary services provided by the combined entity. This benefit is measured as the difference between each dollar of expenditure and the proportion of that made up of the marginal cost of supply, multiplied by the number of additional skier-days. The result is a benefit valuation for those complementary products equivalent to the area ABHG for skiing services.

347. The Commission's view is that this approach is not appropriate for valuing domestic skier-days, although it is for international skier-days. In both cases this spending is likely to represent a transfer of similar spending by the same people elsewhere. In the case of domestic skiers, the claimed benefit would then represent merely a transfer between New Zealand businesses, and thus would not count as a public benefit. As a result, the focus has remained on expenditure on skiing services only. For international visitors, however, the transfer would be likely to be from overseas businesses to New Zealand businesses, and therefore would count as a public benefit. Therefore, in the following analysis of international skier-days, expenditure on both skiing services and complementary on-mountain services has been included.

International Skier-Days

348. For additional skier-days skied by international visitors to New Zealand the position is different. This follows from the Act's focus on the welfare of New Zealanders. In its public benefit guidelines, the Commission made the following statement:

> The 'public' is the public of New Zealand; benefits to foreigners are to be counted only to the extent that they also involve benefits to New Zealanders.

349. The issues raised by the distinction between 'domestic' and 'foreigners' users is discussed at length in the Commission's Decision No. 278 on *Air New Zealand/Ansett*.

350. The Commission's general approach toward the issue is (unlike with domestic consumers) to accord no weight as benefits to surpluses received by foreigner visitors in New Zealand. For the purposes of exploring this argument, it is assumed now that Figure 3 relates only to foreign visiting skiers. Before the proposed acquisition when demand is at D_1, the net welfare gain to New Zealand from supplying those skiing services to foreign visitors is not CEAG as it was for domestic skiers, but CP_1AG; the area of consumers' surplus of P_1EA is no longer relevant as it accrues to foreign visitors. From this it follows that the public benefit to be gained from any expansion in the demand from overseas skiers is limited to the area ABHG, as claimed by the Applicant.

351. The Commission has adopted a range for the increase in days skied by international visitors. By the end of the five year period, this range is 0-3,125 days for 2005. Therefore, the lower bound results in no increase in demand as a result of the proposed acquisition, and so the lower bound is $0. The upper bound of 3,125 days is valued at the difference between the average expenditure on skiing and other on-mountain services and the additional cost of servicing this expenditure. The appropriate average expenditure figure for international visitors is the Applicant's estimate, adjusted to include GST.[32] This results in a figure of $[ ]. The additional cost of servicing this expenditure has been estimated from the Applicant's amended Appendix 15 to be $[ ]. As a result, by 2005, the value of the increase in days skied by international visitors as a result of the proposed acquisition is estimated to have an upper bound of approximately $113,000 pa.

352. There is likely to be a further additional gain from any increase in international skier-days, in the form of extra profits retained in New Zealand as a result of foreign expenditure accruing to New Zealand-based airlines. This will only be a gain to the extent that the international visitors would not otherwise have flown on New Zealand airlines. The level of foreign ownership of the airline would also need to be considered. Such benefits have not been quantified at this stage.

[32] GST should be excluded from the valuation of domestic skier-days as it represents a mere transfer from domestic consumers to central government. However, the valuation of international skier-days should include GST as the transfer is from foreign visitors. In the Commission's valuation of international skier-days, GST has therefore been included.

TABLE 16
Estimate of Annual Benefit from Increase in Output of Skier-Days by 2005 (compared to Baseline 2000)

	Increase in days	Increase in Value
Domestic Skier-Days	0 – 14,965	$0 – 1,079,403
International Skier-Days	0 – 3,125	$0 – 113,000
Total	**0 – 18,090**	**$0 – 1,192,403**

Question:

16. The Commission seeks comment on the methodology used in the valuation of additional skier-days as a result of the proposed acquisition.

Benefits to the Region

The Applicant's Claims

353. The Applicant has provided estimates of the 'benefits to the region'. These estimates are summarised in Appendix 15 of the Application, and discussed on page 40 of the Application itself. The Ruapehu District Council's Economic Analysis of the Ruapehu District is quoted in the Application, indicating that the daily expenditure on average by foreign visitors in New Zealand is $150 (GST inclusive). The Applicant then removes from this figure the average on-mountain spend ($[ ]), which, it is claimed, results in off-mountain expenditure of approximately $[ ] per day. However, the actual figure appears to be $[ ]. The figure of $[ ] is then applied to the expected number of additional overseas skier-days to arrive at an estimate of the additional expenditure in the region. The claimed benefit is $[ ] in the first year, increasing to $[ ] in the fifth year.

The Commission's View

354. To the extent that this expenditure is made by foreign visitors who would not have otherwise come to New Zealand, this can be counted as a benefit. However, the Applicant does not appear to have made any adjustment for any additional costs involved in meeting this expenditure. For example, in the case of the sale of additional food, beverage, and retail sales at the ski fields, the Applicant makes such an adjustment for the extra costs associated with increased skier numbers (refer para 35.6 of the Application). In that case, the adjustment amounts to between 40% and 60% of the additional expenditure on food, beverages, and related on-mountain services. For example, for 2001, the Applicant claims an additional 53,085 skier-days. On each of these days, skiers spend on average $[ ] on food, beverages, and other on-mountain services. This amounts to total expenditure of $[ ]. The additional cost of meeting this expenditure is given in the Application (Appendix 15) as $[ ], which is about

60% of the gross expenditure. However, no such adjustment has been made with respect to the off-mountain expenditure by foreign visitors.

355. The Commission has used a figure of [ ]% to represent the cost of servicing the additional non-ski expenditure by foreign visitors as a result of the proposed acquisition. Average expenditure ($150) less average on-mountain spend ($[ ]) is $[ ], inclusive of GST. Daily net expenditure is estimated to be [ ]% of this figure, or $51.21 per day. Table 17 summarises the estimated net benefits to the region.

TABLE 17
Benefits to the Region

	2001	**2002**	**2003**	**2004**	**2005**
Additional overseas skier-days	0-625	0-1,250	0-1,875	0-2,500	0-3,125
Net regional benefit	**$0-32,006**	**$0-64,012**	**$0-96,018**	**$0-128,025**	**$0-160,031**
Claimed	$[ ]	$[ ]	$[ ]	$[ ]	$[ ]

Question:
17. The Commission seeks comment on the likely extent of benefits to the Mt Ruapehu region as a result of the proposed acquisition.

Summary of Benefits

356. The Applicant has claimed that the proposed acquisition will produce total benefits of $[ ] in the first year, increasing to $[ ] by the year 2005. These benefits result from cost savings, an increase in output, and regional benefits arising from international visitors.

357. However, the Commission has reached a preliminary view, based on the information provided by the Applicant and other parties, that the benefits arising from the proposed acquisition are likely to be considerably smaller than those claimed by the Applicant. Table 18 below summarises the Commission's provisional estimates of the level of total annual benefits attributable to the proposed acquisition by the year 2005. In addition, the Commission has provisionally accepted that one-off savings in capital expenditure of $165,000 in the first year could be achieved as a result of the proposed acquisition.

TABLE 18
Summary of Total Benefits (2005)

	Range	
Cost Savings	$401,000	$401,000
Increased Output	$0	$1,192,403
Regional Benefits	$0	$160,031
Total	**$401,000**	**$1,753,434**

358. The Commission's preliminary view is that by 2005, the benefits arising from the proposed acquisition would be likely to fall within a range of $401,000 - $1,753,434 each year.

Intangible Benefits

The Applicant's Claims

359. The Applicant has claimed a number of intangible benefits arising from the proposed acquisition. The first of these is the development and transfer of expertise between the two ski fields. For example, the Applicant notes that RAL has considerable experience in snow making operations (whereas Turoa has limited experience); RAL has expertise in snow transport and grooming which could be applied to Turoa; and RAL has more experience for operating food, beverage and retail outlets. RAL also has more experience in the operation of detachable lifts.

360. Second, the Applicant claims that the North Island ski fields have an important role as a "feeder" to the South Island fields. To the extent that the North Island fields are successful in attracting people who have not previously skied, and who then take up the sport, the South Island fields are likely to benefit from this growing interest.

361. Third, in addition to an increase in skier-days, the Applicant claims that the proposed acquisition will lead to greater enjoyment as a result of the improved experience.

The Commission's View

362. The first claim relates to the development and transfer of expertise in certain areas from one field to the other. While there may be some benefit arising from single ownership, there is some uncertainty over the extent of any such benefit. For example, while RAL's experience in snow making could be applied to Turoa, the Commission understands that the snow making operations at the two fields have quite different characteristics. At Whakapapa, the operation pumps water through pipes from streams further down the mountain. However, snow making at Turoa is based around a reservoir sourced from snow melt and a small underground spring.

363. Furthermore, with respect to snow grooming, the extent to which expertise could be transferred from one field to the other may be impaired by the different terrain at each field, with Whakapapa having more bluffs and Turoa generally being more open.

364. The claim with respect to the operation of mountain cafeterias may be discounted due to the fact that Turoa has operated such facilities through a concession, and therefore does not require any such experience or knowledge.

365. The Commission accepts that Mt Ruapehu may have an important "feeder" role for the South Island fields. This view has been expressed to the Commission by a number of South Island ski field operators. However, it remains unclear as to the extent to which this role can be better fulfilled under single ownership, given the Commission's preliminary view that much of the claimed increase in skier-days could be secured under separate ownership.

366. Although the proposed acquisition may lead to increased enjoyment, for example as a result of the introduction of a traverse, the Commission has questioned whether this is dependent on the proposed acquisition. Furthermore, any increase in enjoyment is likely to be reflected in increased skier-days, and this has already been considered and valued as a benefit.

Question:

18. The Commission seeks comment on the likely nature and extent of intangible benefits as a result of the proposed acquisition.

BALANCING

367. The determination of the Application involves a balancing of the public benefits and the detriments which will, or will be likely to, result from the proposed acquisition. Only where the detriments are outweighed by the public benefits can the Commission be satisfied that the proposed acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted, and be able to grant an authorisation for the proposed acquisition.

368. The Commission has made a preliminary assessment of the benefits to the public arising from the proposed acquisition and the detriments caused by the acquisition of dominance.

369. A summary of the Commission's preliminary views as to the ranges within which the detriments are likely to fall, and the benefits which can be accepted, if the proposed acquisition proceeds, is shown in Table 19.

TABLE 19
Summary of Preliminary Estimates of
Annual Detriments and Benefits by 2005

Category	Range ($ per annum)
Benefits	401,000 - 1,753,434
Detriments	764,000 – 3,380,000

370. As indicated in the text of this Draft Determination, the Commission has taken the view that the likely outcome would be towards the lower end of the benefit range. As a consequence, given the detriment range, the benefits are likely to be outweighed by the detriments, and based on the current information the Commission is likely to decline to authorise the proposed acquisition.

Question:

19. The Commission seeks comment on whether the issues that have been considered in this Draft Determination provide a reasonable summary of the issues of which it should be aware before making a final decision on this Application. The views of interested parties are sought on any additional issues that might be of relevance when considering the benefits or detriments to the public that might result from the proposed acquisition, should it proceed.

DRAFT DETERMINATION

371. On the basis of the information available to it to date, the Commission has reached the preliminary view that it cannot be satisfied that the public benefits of the proposed acquisition are likely to outweigh the competitive detriments.

372. If this conclusion is confirmed, following consideration of submissions on this Draft Determination, the Commission would decline to grant an authorisation pursuant to section 67(3)(c) of the Commerce Act.