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COMMERCE COMMISSION

Decision No. 478

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

CUSTOM FLEET (NZ) LIMITED

and

HERTZ FLEETLEASE LIMITED

The Commission:	MJ Belgrave Peter Taylor D Bates QC
Summary of Application:	The acquisition by Custom Fleet of the whole of the issued share capital of Hertz Fleetlease from Ford Motor Credit Company.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	31 October 2002

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THE PROPOSAL

1. On 16 October 2002 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") from Custom Fleet (NZ) Limited ("Custom Fleet") for it to acquire the whole of the issued share capital of Hertz Fleetlease Limited ("HFL") from Ford Motor Credit Company ("Ford Credit").

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Accordingly, a decision on the application was required by 31 October 2002.

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

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

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

THE PARTIES

Custom Fleet

6. Custom Fleet (NZ) Limited ("Custom Fleet") is a wholly owned subsidiary of the Bank of New Zealand ("BNZ") which in turn is a wholly owned subsidiary of the National Australia Bank Limited ("NAB"), a company listed on the Australian stock exchange.
7. Custom Fleet (and its Australian counterpart, also called Custom Fleet) provide fleet leasing and fleet management services. Custom Fleet started operations in New Zealand in 1996.

Hertz Fleetlease

8. Hertz Fleetlease Limited ("HFL") is a wholly owned subsidiary of the Ford Motor Credit Company.
9. HFL provides fleet leasing and fleet management services, as well as operating an office equipment leasing business.

OTHER RELEVANT PARTIES

Esanda Fleet Partners ("Esanda")

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

10. Esanda was established in New Zealand in September 1998 and is a wholly owned subsidiary of the ANZ Bank.

11. It previously traded as Avis Lease and Truck Leasing Ltd. Under the brand Avis Lease it was involved in the full maintenance leasing of motor vehicles from 1977. Truck Leasing Ltd was established in 1988 and was New Zealand's first major truck leasing company. Esanda provides fleet leasing and fleet management services and is one of the largest vehicle lessors in Australasia.

Orix New Zealand Limited ("Orix")

12. Orix was incorporated in New Zealand in 1989, after the ORIX Corporation entered the New Zealand market in 1988 by purchasing the operating lease division of an international car rental company. Orix is a wholly owned subsidiary of the Orix Corporation of Japan. The Orix Corporation is a major international finance company.

13. Orix provides fleet leasing and fleet management services.

Leaseplan New Zealand Limited ("Leaseplan")

14. Leaseplan was established in New Zealand in 1993, and is a wholly owned subsidiary of ABN AMRO Lease Holding, which in turn is a wholly owned subsidiary of ABN AMRO Bank.

15. Leaseplan provides fleet leasing and fleet management services.

GE Capital Fleet Services (NZ) Limited ("GE")

16. GE is a wholly owned subsidiary of the General Electric Corporation, and has been a participant in the market since purchasing Giltrap Leasing Limited in 1998.

17. In addition to a range of other financial products, GE provides fleet leasing and fleet management services.

Cardlink Systems Limited ("Cardlink")

18. Cardlink was established in 1984 and is an independent company.

19. Cardlink Systems provides fleet and loyalty solutions and fleet management services. Cardlink is focused on systems and services to support fuel card systems, fleet and vehicle management systems, relationship marketing, and loyalty programmes. Cardlink is the largest non-bank provider of charge card services in New Zealand.

Holden Financial Services ("Holden Financial")

20. Holden Financial is a wholly owned subsidiary of GMAC financial services, which is in turn a wholly owned subsidiary of the General Motors Corporation.

21. In addition to a range of other products, Holden Financial offers leasing services through the Holden network of dealers. Holden Financial started operations in New Zealand in 1971.

INDUSTRY BACKGROUND

Fleet leasing

22. Fleet leasing refers to entering into an arrangement with an organisation to provide leases for all (or a large number of) the cars used by that company. A vehicle lease is a financial instrument used to fund the acquisition or use of a motor vehicle. There are two types of leases, an *operating* lease and a *finance* lease:

    - An operating lease is the provision of a vehicle for a fixed monthly rental for a specific contract period and distance (kilometres). Title is retained by the lessor and the vehicle is off-balance sheet for the lessee. All risks associated with residual value are taken by the lessor.

    - By contrast, a finance lease provides that while the lessor also retains title, the vehicle is on-balance sheet for the lessee who takes the risk of the residual value.

    Additional services may be provided in conjunction with either type of lease.

23. In addition to finance leases and operating leases, companies active in this industry sector may also offer a range of other finance products, such as novated leases, chattel mortgages or cash plans. A range of additional services, such as the use of a fuel card, may be offered as part of an overall package.

24. Fleet management services are often provided as part of a lease package, but may also be excluded from the lease package.

Fleet management

25. This term fleet management is used to describe the provision of "outsourcing solutions" covering all aspect of a company's vehicle fleet, with fleet managers effectively running the entire fleet operations of their customers. A customer's decision to purchase fleet management services is separate to their decision on how to fund their vehicles, ie the service can be provided regardless of whether the customer owns the fleet itself or whether the fleet is financed externally. Management services include:

    - maintenance and servicing packages;
    - registration, fines and toll management;
    - vehicle acquisitions and disposals;
    - accident management and breakdown services, including driver assistance;
    - insurance options and protection plans;
    - comprehensive fleet management reporting; and
    - risk assessment and practical driver training.

26. Some fleet managers also provide card purchasing services (such as cards which may be used for the purchase of fuel and oil) and other specialist services, such as vehicle salary packaging services, on-line services and the re-marketing of ex-leased vehicles.

MARKET DEFINITION

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

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

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

29. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:
    - the goods or services supplied and purchased (the product dimension);
    - the level in the production or distribution chain (the functional level);
    - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
    - the temporal dimension of the market, if relevant (the timeframe).

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

31. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one.

The Commission's Previous Decisions

32. The Commission has not previously considered the market for fleet management and fleet leasing services. However, the Commission referred to motor vehicle leasing in Decision 461 *GE Capital Finance Australasia Pty Limited/Australian Guarantee Corporation (NZ) Limited*, where the Commission specifically excluded motor vehicles from the market for the supply of consumer finance. The Commission noted that motor vehicle finance was one of four groups of finance products (the others being consumer finance, business finance and insurance).[2]

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[2] Paras 29, 30.

The Applicant's Proposed Market Definition

33. The applicant considers that the provision of vehicle leasing services could fall within a broader banking and financial services market, consistent with the Commission's comments in Decision 461, where it was noted that:

- "Globally, the financial services industry is experiencing convergence – a lessening of the distinctions that have separated different types of financial products and services as well as the providers of these once-discrete products and services."[3];

- "Banks, finance companies, building associations and several other types of organisations offer an increasingly wide range of financial services to consumers and business."[4];

- the applicant noted that it was debatable whether or not consumer finance and business finance constitutes separate markets, or segments of a "wider lending and financial services market."[5];

- "It can be argued that a number of finance products are substitutable on the demand side."[6]

34. The applicant has submitted that both Custom Fleet and HFL supply their services to business customers, primarily because this is where there is a greater volume of business (ie the accounts are much bigger) and there is greater scope for more lucrative value-added services (the focus on business customers is incorporated in the above market definitions through the reference to "fleets"). These "value-add" services may either be the arrangement of insurance and other services which are ancillary to the lease (and thus part of the lease service), or relate to broader fleet management services (although there may be a degree of overlap between the two). Conversely, vehicle manufacturers and dealers have tended to focus on consumer (ie non-business) customers. However, the applicant submits that there is a very high degree of supply-side substitutability between these two customer groupings and the pricing is highly correlated (taking into account sales volumes, value, additional services, etc).

35. In Decision 461 the Commission also commented that, while some market segments crossed into other market segments (which it considered would "blur the product definition"), "most market participants argue that motor vehicle finance products should be in a class of their own".[7] Given these comments and the fact that the Commission may, in accordance with its usual practice, choose to adopt a "conservative" approach to market definition, the applicant has, for the purposes of this application only, adopted narrow market definitions. These are:

- a national market for the provision of fleet leasing services; and

- a national market for the provision of fleet management services.

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3 Para 24.
4 Para 27.
5 Para 41.
6 Para 43.
7 Para 42.

Product Dimension

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

37. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[8] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

Demand-side substitution

38. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

Supply-side substitution

39. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

<u>Vehicle leases and other finance products</u>

40. It is arguable that leases and other finance products are substitutable on the demand side. As the Commission noted in Decision 461:

    "Whilst there are variances between the different forms of lending with different terms, interest rates, payment conditions, and so on, consumers tend to utilise the different lending formats interchangeably."

41. However, there are distinct supply side characteristics of leasing companies. In particular, a crucial part of leasing a vehicle is being able to assign an accurate residual value. The

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

specialist expertise of lease providers in being able to assign accurate residual values to motorcars suggests vehicle leases are in a separate market from other finance products.

Operating and Finance Leases

42. The applicant submits that though some customers may, at a particular point of time prefer one lease type over the other, the two types are substitutable and many customers switch from one type to the other. For example, some customers may elect a finance lease for GST reasons (eg they obtain an immediate input tax credit). Other customers may choose an operating lease in order to remove the vehicles from the balance sheet, remove resale risk, remove maintenance risk etc. However, the applicant submits that it is industry practice to treat the two forms of lease as falling within the same market, and Custom Fleet considers that the two forms of car lease are substitutable from both the supply and demand sides.

43. Industry participants advised the Commission that operating and finance leases are readily substitutable and are considered to fall within the same market. Furthermore, customers readily switch between them based on their particular requirements.

44. The Commission considers that finance and operating are substitutable on both the demand and supply side and therefore fall within the same market.

Undifferentiated/Differentiated Products

45. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

46. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

Fleet Leases

47. The applicant submits that fleet leasing services are standardised to the extent that price forms a key part of customers' purchasing decisions. However, market participants seek to differentiate themselves in a variety of ways, including the range of financing options and vehicles which they offer, and service quality. The key differentiating characteristics between competing suppliers are:

- the brand/image of suppliers (primarily reflecting reliability, flexibility);
- service (response time, knowledge of products, ease to deal with, etc); and
- price (clients will be looking for the best deal, taking into account value of the underlying vehicle, timing of payments, additional fees, etc).

Most players also seek to enhance the service element of their offering by offering fleet management services. While the products are differentiated they are seen as close substitutes for one another.

Fleet Management

48. The applicant submits that product differentiation plays an even greater role in the case of fleet management services where reliability, speed of service, and rapport between provider and customer are all important. Fleet management services are differentiated on the same bases as fleet leasing above. However there will be a more obvious trade-off between price and service, with reliability of service playing a greater role.

Analysis of product differentiation

49. The Commission is aware of the differentiation aspects of fleet leasing and fleet management noted above and has further addressed these characteristics at paragraphs 68 to 72. However, it considers that the fleet leasing and fleet management markets are largely undifferentiated given that customers have multiple contracts with various fleet management and fleet leasing firms and consumption decisions are based predominantly on price. Thus, the Commission considers that the fleet leasing and fleet management markets are not sufficiently differentiated to warrant the special analysis associated with fully differentiated products.

50. The Commission proposes to adopt a conservative approach in the definition of the appropriate markets and assess the competitive effect of the transaction within narrowly defined markets. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product markets are:

- The market for the provision of fleet leasing services;
- The market for the provision of fleet management services.

Geographic Extent

51. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

52. At the lower end of the market, there are a number of small fleet leasing and fleet management companies operating at a localised level. However, there are also a number of market participants who operate through branches in the major urban centres, providing fleet leasing and fleet management services on a national basis. Industry participants spoken to advise that they considered the markets for the provision of fleet leasing and fleet management services to be national.

53. The Commission concludes that for the purposes of the current application the geographical market is New Zealand.

Functional Level

54. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[9] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

55. The functional level is the supply of fleet leasing services and fleet management services

Conclusion on Market Definition

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

- The market in New Zealand for the provision of fleet leasing services;
- The market in New Zealand for the provision of fleet management services.

COMPETITION ANALYSIS

Substantially Lessening Competition

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

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

58. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[10]

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

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

What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[11]

59. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[12]

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

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.[13]

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

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

and, in relation to s47:

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

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

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

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

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

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

for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

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

65. In the absence of Custom Fleet purchasing HFL, Ford Credit may sell HFL to another party. The Commission is aware that in particular [

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66. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[14] Therefore, for the purposes of the competition analysis the Commission considers that the status quo is the most appropriate approximation for the counterfactual as HFL would continue to operate as a major fleet leasing and fleet management service provider in the absence of the proposed merger proceeding.

67. The Commission therefore proposes to use the status quo as the counterfactual.

Potential Sources of Market Power

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

69. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one year time frame.[15] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

70. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics

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[14] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.
[15] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

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

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

72. In the context of fleet management and fleet leasing markets as defined, where price, product quality and service are taken into account by purchasers in choosing between competing providers, the product is differentiated to a small degree. However, as mentioned above, the Commission does not consider that the fleet management and fleet leasing markets are sufficiently differentiated to warrant the special analysis associated with fully differentiated products.

Conclusion – Competition Analysis Principles

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

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

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

ANALYSIS OF EXISTING COMPETITION IN THE FLEET LEASING MARKET

Introduction

75. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Existing Participants

76. The applicant contends that the fleet leasing services market is vigorously contested. The fleet leasing services market includes a wide range of competitors, from specialist fleet lessors (collectively referred to within the industry as "core" service providers) to those offering a more general range of products (collectively referred to as "non-core" service providers). Thus, the applicant submits that there are a significant number of competitors offering fleet leasing services in addition to those listed from paragraph 11 of this report. These include:
    - Toyota Finance;
    - Ford Credit;
    - Canterbury Finance;
    - Flexi Autolease;
    - Allied Finance;
    - Diamond Leasing;
    - Auckland Finance;
    - Spears Finance; and
    - Dealers:
        - Ford Network (200 dealers);
        - Holden Network (160 dealers);
        - Toyota Network (120 dealers); and
        - Mitsubishi Network (80 dealers).

Market Shares

77. The Commission proposes to use fleet size as the primary measure of market share and concentration in the fleet leasing market. National shares for the market are shown in Table 1 below. The estimated book value of participants is also shown, and generally the market share by fleet size is similar to market share by book value.

Table 1: Estimated National Market Shares for the Supply of Fleet Leasing Services

Supplier	**Owner(s) of Supplier**	**Estimated number of vehicles**	**Estimated Book Value ($M)**	**Estimated % market share (vehicles)**	**Estimated % market share (Book Value)**
Hertz Fleet Lease	Ford	[ ]	[ ]	[ ]	[ ]
Custom Fleet	NAB	[ ]	[ ]	[ ]	[ ]
Merged Entity	*NAB*	[ ]	[ ]	[ ]	[ ]
Esanda Fleet Partners	ANZ Bank	12,420	320	[ ]	[ ]
ORIX Fleet Management	ORIX Japan	9,450	200	[ ]	[ ]
Leaseplan	ABN AMRO	4,050	70	[ ]	[ ]
GE	GE Corp	[ ]	[ ]	[ ]	[ ]
Other	Various	[ ]	[ ]	[ ]	[ ]
Total		**[ ]**	**[ ]**	**100%**	**100%**

78. The current three firm concentration, including only those companies listed above, is [ ]%. Post merger, the three firm concentration ration would be [ ]% with the merged entity having a [ ]% share. These figures are outside the Commission's safe harbours.

79. However, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition.

State of Existing Competition

80. Most Industry participants spoken to by the Commission did not oppose the acquisition, and considered that it would not have a negative impact on the competitiveness of the market. However, [

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81. The Commission received indications of the market being vigorously contested. In addition to the six current specialist lease providers, there are at least nine other companies who offer leases as part of their finance product range, excluding the car dealers themselves. In particular, Esanda and Orix Fleet Management are substantial competitors with equal standing and no barriers to expansion in the relevant market.

82. In addition to the tender process (discussed below) with which fleet leasing providers compete for clients, providers utilise sales teams that make presentations to potential clients. Sales teams are responsible for securing around [ ]% of new clients.

83. As well as constraint from competitors within the market there is considerable constraint from outside the market. For instance, customers who are contemplating leasing their fleet have the option of owning themselves or one of the many other forms of finance available (e.g. bank loans or funding from their own cash flows). Lease companies indicated to the Commission that it is relatively common for customers to change their arrangement in this way.

84. The Commission concludes that existing competition from other fleet leasing companies is sufficiently robust to constrain the merged entity.

Conclusions – Unilateral Market Power

85. The Commission considers that the merged entity will be constrained by current competition in the fleet leasing market.

Scope for the Exercise of Coordinated Market Power

Introduction

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

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

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

Collusion

89. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

90. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 2. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the fleet leasing market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

TABLE 2
Testing the Potential for 'Collusion' in the fleet leasing market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes – market concentrations for fleet leasing and fleet management of [ ]% and [ ]% respectively
Undifferentiated product	No
New entry slow	No – entry barriers are low and there are no barriers to expansion
Lack of fringe competitors	No
Price inelastic demand curve	No – customers shop for the best 'spot price' and customer have a range of funding and management options
Industry's poor competition record	No
Presence of excess capacity	No
Presence of industry associations/fora	None

91. The assessment of the relevant structural and behavioural conditions in the fleet leasing market in Table 2 suggests that the market is not particularly likely to be susceptible to collusion, even after the acquisition. The levels of concentration in the markets are only moderately high, even when the markets are drawn conservatively. Barriers to entry are low and customers have reasonable countervailing power. In addition, prices are often set by tender, meaning that prices are not that transparent.

92. The Commission is therefore satisfied that the defined markets are unlikely to facilitate collusion. As such, the Commission has found it unnecessary in this case to go on to determine the potential for discipline the fleet leasing market.

Conclusions – Co-ordinated Market Power

93. The Commission has determined that the scope for the exercise of co-ordinated market power in the fleet leasing market would not be enhanced by the acquisition.

Conclusions – Existing Competition

94. The Commission considers that existing competition in the fleet leasing market will alleviate any concerns of unilateral power being exercised by the merged entity.

95. The Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

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

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

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

Barriers to Entry

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

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

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

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

103. Industry participants spoken to stated that it is not difficult to enter the fleet leasing market or expand having entered. Market participants suggest that the value of the fleet leasing market is likely to rise as more businesses realise the benefits of leasing over ownership. A survey completed by Watson Wyatt in 2001[16] concluded that of the participating organisations which operated company vehicle schemes in New Zealand:

[16] Company Car and Vehicle Allowance Policies: Trends in New Zealand (October 2001)

- 48% owned their fleets;
- 33% leased their fleets; and
- the remaining 19% used a mix of ownership and leasing.

104. Industry participants believe that within a relatively short period up to 50% of New Zealand companies will lease their fleets. This development would be consistent with leasing level trends in Australia, Europe and the United States, and would result in the creation of additional incentives for new entry and expansion in the market.

105. A new entrant in the market is not prohibited from competing on similar terms with existing players because of potential economies of scale in sourcing new vehicles, i.e. existing players cannot necessarily purchase new vehicles at a lower price than a new entrant. This is because discounts from vehicle distributors are based on the fleet size of the *client*, rather than the number of leases funded through a particular leasing company. A new entrant is therefore capable of sourcing new vehicles from a distributor at similar rates to existing competitors, and clients will have no reason to discriminate between a new entrant and an existing competitor because of a difference in the price of a new vehicle. Thus, there is no barrier to entry arising from existing economies of scale in purchasing new vehicles.

106. The Australian industry has witnessed new entry in the past 5-10 years by Summit (owned by the Sumitomo Bank of Japan) and Macquarie Bank. Within that same period, Custom Fleet entered the New Zealand market.

107. [

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108. There are no significant impediments preventing a current competitor from expanding or a new competitor entering the market.

The "LET" Test

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

Likelihood of Entry

110. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market

unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

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

112. Entry is likely to occur by a fleet leasing and fleet management company with the backing of a major bank. Custom Fleet entered the New Zealand market as a start-up in 1996 with the backing of NAB and has grown to attain an [ ] market share. The Australian experience (above) also indicates that entry into the New Zealand market is likely on commercial terms by participants not currently active in the market, such as Summit or the Macquarie Bank

113. The applicant considers that [

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Extent of Entry

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

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

116. The experience of Custom Fleet in the New Zealand market is evidence that it is possible to enter the market to a significant extent. [

].

117. Existing market participants and new entrants are not limited in their ability to expand, subject to securing vehicles and finance at economical rates, and could do so within a one year timeframe. Participants face no binding capacity constraints and additional capacity is not significantly more expensive to operate. As such, the market could be entered to a significant extent within a reasonable timeframe.

Timeliness of Entry

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

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

120. The applicant submits that entry could occur relatively quickly. [ ]

Conclusion on Barriers to Entry

121. The Commission concludes that there are no significant barriers to entry likely to deter expansion or new entry. Potential competition, in addition to the strength of existing competition in the fleet leasing market, is likely to provide a constraint on the merged entity, and the industry as a whole.

OTHER COMPETITION FACTORS

Elimination of a Vigorous and Effective Competitor

122. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

123. While HFL competes actively for customers in the defined markets, it is not markedly different from any other firm in that respect. Given the constraints listed above, its removal is unlikely to have a disproportionate effect on competition.

Constraint from Buyers or Suppliers

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

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

126. Customers contacted by the Commission advised that it was easy to switch suppliers of fleet leasing services. The switching costs of changing suppliers were negligible and considered no barrier by customers. With a number of providers in the market the customers did not feel they were limited in their selection.

127. Customers typically retain the services of at least two fleet leasing companies and switch between them when leasing individual vehicles on the basis of the competitiveness of a quoted “spot” price. Companies retain the services of a company through a tender process (both open and closed). Generally, following a tender two or three providers enter into a master lease agreement with the tenderer for a period of 1-2 years. This allows the tenderer to avoid the administrative requirements of individual leases and to streamline the process in general. There is no obligation for a company to lease from a provider with which they have entered into a master lease agreement.

128. The ease with which customers can switch fleet leasing companies and the presence of several market players limit the ability of providers to impose uncompetitive rates on customers. The ability of a company to self-finance a fleet also limits the ability of providers to impose uncompetitive rates.

CONCLUSION -FLEET LEASING MARKET

129. The Commission considers that existing competition in the fleet leasing market is sufficiently robust to counter the effect of the merged entity’s increased market share. Furthermore, low barriers to entry and the countervailing power of customers will limit the merged entity’s ability to exercise market power.

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

ANALYSIS OF EXISTING COMPETITION IN THE FLEET MANAGEMENT MARKET

Scope for Unilateral Market Power

Existing Participants

131. The applicant contends that the fleet leasing services market is vigorously contested. The fleet management services market includes a range of competitors, and includes the specialist fleet lessors listed from paragraph 11 of this report.

Market Shares

132. The Commission proposes to use fleet size as the primary measure of market share and concentration in the fleet management market. National shares for the market are shown in Table 3 below.

Table 3: Estimated National Market Shares for the Supply of Fleet Management Services

Supplier	Owner(s) of supplier	Estimated number of vehicles	Estimated % market share (vehicles)
Custom Fleet	NAB	200	0.5
HFL	Ford	5,954	16.2

Merged entity	NAB	6,154	16.7
Cardlink Systems	Privately owned	18,000	49.1
Esanda	ANZ	6,500	17.7
Lease Plan	ABN AMRO	6000	16.4
Total		**36,654**	**100**

133. The current three firm concentration, including only those companies listed above, is [ ]%. Post merger, the three firm concentration ration would be [ ]% with the merged entity having a [ ]% share. These figures are within the Commission's safe harbours.

State of Existing Competition

134. Industry participants spoken to by the Commission did not oppose the acquisition, and considered that it would not have a negative impact on the market.

135. The Commission received indications of the market being vigorously contested. Within this market, the merged entity is dwarfed by Cardlink Systems. It also faces competition from Esanda and Leaseplan, who are substantial competitors with equal standing and no barriers to expansion in the relevant market.

136. As well as constraint from competitors within the market there is considerable constraint from outside the market. For instance, customers who are contemplating fleet management have the option of managing themselves. Fleet management companies indicated to the Commission that it is relatively common for customers to organise themselves in this way.

137. Market participants suggest that the value of the fleet management market is likely to rise as more business realise the benefits of fleet management over self-management.

138. The Commission concludes that existing competition from other fleet management companies is sufficiently robust to constrain the merged entity.

Conclusions – Unilateral Market Power

139. The Commission considers that the merged entity will be constrained by current competition in the fleet management market. As the merged entity is also below the Commissions safe harbours in the fleet management market, the Commission does not consider it necessary to discuss constraints from market entry or other competition factors.

OVERALL CONCLUSION

140. The Commission has considered the probable nature and extent of competition that would exist in the defined markets. The Commission considers that the appropriate benchmark for comparison is the status quo.

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

market share which falls outside the Commission's safe harbour guidelines in the fleet leasing market

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

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

143. Existing competition in the defined markets is sufficiently robust to counter the effect of the merged entity's increased market share. Furthermore, low barriers to entry and the countervailing power of customers will limit the merged entity's ability to exercise market power.

144. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in New Zealand in the defined markets.

DETERMINATION ON NOTICE OF CLEARANCE

145. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Custom Fleet (NZ) Limited to acquire the whole of the issued share capital of Hertz Fleetlease Limited from Ford Motor Credit Company.

Dated this 31st day of October 2002

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MJ Belgrave
Chair