

Statement of Preliminary Issues

Menzies Aviation / Skystar NZ

13 September 2013

Introduction

1. On 22 August 2013, the Commerce Commission received an application from Menzies Aviation New Zealand Limited (Menzies), seeking clearance to acquire 100% of the shares of Skystar Airport Services NZ Pty Limited (Skystar). The public version of the application can be accessed on our website at:
<http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/792>
2. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on us.
3. We invite interested parties to make comment on the likely competitive effects of the proposed merger and request that parties who wish to make a submission do so by Tuesday 24 September 2013.

The transaction

4. The Application relates to Menzies' proposed acquisition of 100% of the shares of Skystar. The proposed acquisition forms part of the acquisition by Menzies Aviation Holdings Pty Limited of Skystar Airport Services Pty Limited in Australia.

Relevant parties

The acquirer – Menzies Aviation (New Zealand) Limited (Menzies)

5. Menzies is part of the Menzies Aviation Group, which provides ground handling, cargo handling, and cargo forwarding services in 30 countries throughout the world. In New Zealand, Menzies provides ground handling services (either itself, or through a subcontract with Planebiz Limited) to Virgin Australia, Singapore Airlines and Emirates at Christchurch Airport, and to Virgin Australia at Dunedin Airport. Menzies is ultimately owned by Menzies Aviation Plc and John Menzies Plc (both registered in the United Kingdom).

The target – Skystar Airport Services NZ Pty Limited (Skystar)

6. Skystar forms part of the Monadelphous group of companies, which provides ground handling services at eight airports in Australia and New Zealand. In New Zealand, Skystar provides ground handling services for narrow bodied commercial aircraft operated by Jetstar at Christchurch and Dunedin Airports.

Our framework

7. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.¹ As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.
8. This test asks whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
9. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely. This is because the more closely substitutable two products are, the closer the competition between them and the greater the competitive constraint between those products.
10. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.³
11. We analyse the extent of competition in each relevant market for both the with and without scenarios in terms of the following.
 - 11.1 Existing competition – the degree to which existing competitors compete and their ability to expand production in the event that the merged firm raises prices.
 - 11.2 Potential competition – the ability of businesses to readily enter the market on sufficient scale in order to provide competitive constraint.
 - 11.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser’s ability to exert an influence on price, quality and/or terms of supply.
 - 11.4 Coordinated behaviour – conditions that make market participants likely to collude either tacitly or explicitly.

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013.

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

12. A comparison of the extent of competition both with and without the acquisition enables us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed acquisition.

Preliminary issues

13. We are currently focusing our investigation on the following areas.

Market definition

14. We define markets in the way that we consider best isolates the key competition issues that arise from the merger.
15. The proposed acquisition involves overlap in the provision of ground handling services at Christchurch Airport and Dunedin Airport. Therefore, Menzies has submitted that the relevant markets are the provision of ground handling services (comprising ramp, passenger, and baggage handling services) at Christchurch and Dunedin Airports.
16. Ground handling services at airports throughout New Zealand are generally provided under contracts entered into between the customer airlines and ground handling agents. The only major exception appears to be Air New Zealand, which provides ground handling services for its own aircraft, but contracts to provide such services to other airlines at airports throughout New Zealand. Menzies submitted that the average contract length for ground handling services is three years.
17. Menzies has considered whether there are two distinct product markets: the provision of ground handling services for wide bodied aircraft and ground handling services for narrow bodied aircraft. We will consider whether providing ground handling services for narrow and wide bodied planes are sufficiently different such that those services can be considered distinct product markets.
18. Skystar's ground handling operations in New Zealand are currently confined to narrow bodied aircraft, but we will also consider whether Skystar is a potential competitor for providing ground handling services to wide bodied aircraft.
19. We will consider whether the geographic scope of the market(s) is local, such as for Christchurch and Dunedin, or whether other aspects may lead to a broader geographic scope, such as airlines contracting on a national basis.
20. At the local level, we will investigate whether Skystar has previously bid, or is likely to bid for contracts at any airports in addition to Christchurch and Dunedin. This will enable us to consider whether any other geographic locations are likely to be affected by the proposed acquisition.

Existing competition

21. Menzies has submitted that post-acquisition the merged entity would continue to face strong competition from Air New Zealand, which it views as the largest provider

of ground handling services in New Zealand. While Menzies submitted that Air New Zealand may not be a competitor in respect of the provision of services to Jetstar, it considers Air New Zealand is a significant competitor for other airlines' business, particularly Virgin Australia. In addition, Menzies identified SkyCare Airline Services (SkyCare), which provides ground handling services for Jetstar at Auckland, Wellington and Queenstown, as an existing competitor in respect of contracts for narrow bodied aircraft, and with the scope to expand to provide services at Christchurch and Dunedin Airports.

22. We will examine the extent to which existing ground handling service providers, including Air New Zealand and SkyCare, would constrain the merged entity.

Potential competition

23. Menzies has submitted that there are low barriers to entry in the provision of ground handling services because:
- 23.1 the set up costs for the establishment of an operation, such as Skystar, which involves narrow bodied aircraft, is likely to be approximately \$200-300,000, although it notes ground handling services for wide bodied aircraft is likely to incur significantly higher costs (\$2-3million);
 - 23.2 a new supplier can viably enter the market in at least three to six months, and an established supplier (such as SkyCare), in as little as two to three months; and
 - 23.3 there are few regulatory requirements.
24. We will consider whether entry would be likely to occur on a sufficient scale, and in a timely manner, so as to provide effective competition to the merged entity.

Countervailing power

25. Menzies has submitted that it would continue to face a significant degree of countervailing power from its customer airlines due to the strong bargaining power held by these airlines. It also considered that airlines are readily able to switch suppliers and have the ability to assist a new entrant, as evidenced by Skystar's own entry into ground handling in New Zealand. We will examine the extent to which customers would sponsor new entry, self-supply, or discipline Menzies in other markets in the event the merged entity raised prices.

Next steps

26. In line with our Merger and Acquisitions Guidelines (available on our website at www.comcom.govt.nz), we have established a draft timeframe for consideration of the issues and Menzies' application for clearance. An extension of time was agreed to by Menzies such that we should make our final decision by 17 October 2013.

27. To keep up to date with changes in relation to timing and to find relevant documents, visit the Clearance Public Register on our website at:

<http://www.comcom.govt.nz/clearances-register/>
28. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above. We will be contacting those parties over the next few weeks.
29. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please send it to the Registrar, at registrar@comcom.govt.nz with the reference Menzies/Skystar in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business **Tuesday 24 September 2013**. Please clearly identify any confidential information contained in the submission and provide contact details.