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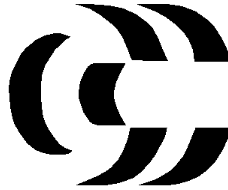

COMMERCE COMMISSION

Decision No. 410

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).
Determination:	The Commission determines that it will grant an authorisation for the proposed acquisition pursuant to section 67(3)(b) of the Act.
Date of Determination:	14 November 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 Act, Ruapehu Alpine Lifts Limited (“the Applicant”) gave notice to the Commerce Commission (“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. The Application was registered by the Commission on 31 July 2000. 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.
3. The Commission released its Draft Determination on 28 August 2000, in which it reached the preliminary view that it could not be satisfied that the public benefits of the proposed acquisition were likely to outweigh the competitive detriments. The Commission stated that on the basis of the information provided to that date, it would be likely to decline an authorisation for the proposed acquisition pursuant to section 67(3)(c) of the Act.
4. The Commission sought submissions on its Draft Determination and asked for further information and comment on 19 questions that it posed in the Draft Determination.
5. On 1 September 2000, the Commission agreed to the Applicant’s request for a two week extension. The Applicant requested additional time in order to respond to the Commission’s requests in the Draft Determination for further information.
6. Pursuant to section 69B of the Act, the Commission held a Conference in Wellington between 18-20 October 2000 to allow interested parties to make oral submissions on the Draft Determination. Up to the commencement of the Conference, the Commission had received in excess of 280 submissions including six from experts. A list of interested parties, and those parties who made submissions at the Conference, is attached to this report as Appendix A.
7. On 2 November 2000, an extension of five working days was sought by the Commission, and agreed to by the Applicant. Accordingly, a final Determination on this matter is required by 14 November 2000.
8. 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.
9. 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).
10. If the Commission is not satisfied as to the matters referred to in paragraphs 8 and 9 above, the Commission must decline to grant an authorisation under section 67(3)(c).

11. 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 final Determination. When that confidentiality order expires, the provisions of the Official Information Act 1982 will apply to that information.

12. The Commission's final Determination is based on an investigation conducted by its staff; oral and written submissions from members of the public and interested parties; and subsequent advice from staff to the Commission.

THE PARTIES

Ruapehu Alpine Lifts Limited ("RAL")

13. RAL is a public unlisted company registered under the Companies Act 1993. RAL operates the Whakapapa ski field on the north-western 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, snow making and grooming, ski patrol, and other facilities required by skiers. This does not include the provision of on-site accommodation services.

14. 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)(h) and (j) of the Income Tax Act 1994. This exemption is dependent on RAL maintaining its current objective and constitutional restrictions.

15. 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.

16. RAL has a Board of six Directors, who serve three year terms, two of which come up for re-election every year. The Commission was told that RAL's Annual General Meeting is attended on average by approximately 50-60 shareholders, and that an estimated 500-900 proxy votes are received in the election of Directors.

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

17. TSR is registered under the Companies Act 1993. TSR operates the Turoa ski field on the south-western slopes of Mt Ruapehu, 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, snow making

and grooming, and other facilities required by skiers. This does not include the provision of on-site accommodation services.

18. 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.

19. TSR was placed in receivership on 2 March 2000, but continues to operate as a going concern under the Receiver.

Sutton McCarthy Limited ("Sutton McCarthy")

20. Sutton McCarthy provides corporate and strategic financial advice to corporations and institutions both in New Zealand, and overseas. The Company based in Wellington has been operating for six years.

21. Sutton McCarthy is one of the alternative bidders to acquire TSR and is an interested party in the Commission's process. Two of Sutton McCarthy's principals, Mr Keith Sutton ("Mr Sutton") and Greg McCarthy, were present at the Conference. Mr Sutton spoke at the Conference along with two experts, Dr Adolf Stroombergen ("Dr Stroombergen") of Infometrics Consulting; and Mr Don Esslemont ("Mr Esslemont") of Decision Research Limited.

BACKGROUND

New Zealand Ski Industry

22. 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 snow 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 skied in New Zealand.

23. 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.

24. Club fields are run by ski clubs and are primarily used by their members. 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 involve walk-in access.

25. The New Zealand ski industry is estimated as having 1.1 million skier-days per year. The North Island accounts for approximately 40% of that figure.

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

    - more reliable weather, which is reflected in a fewer number of closed days;
    - dry snow conditions and powder snow, while snow on the North Island ski fields tends to be wetter;
    - a greater variety of terrain given the proximity of many of the ski fields to each other;
    - shorter lift queuing times; 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.

27. 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, by generating interest and enthusiasm for skiing amongst North Islanders.

North Island Ski Fields

28. 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.

29. 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 the “Whakapapa 1995 Survey”[1] that 97% of skiers sampled at Whakapapa were from the North Island.

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

31. 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 per 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.

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[1] *Whakapapa Ski Field Final Report*, prepared for Ruapehu Alpine Lifts by CM Research (NZ) Limited, January 1995.

32. 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.

33. 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.

34. Skiers on North Island fields predominantly tend to be from the North Island. Industry participants commented that the low percentage of international and South Island skiers at North Island ski fields was explained by the lack of marketing, ski resort towns and the perceived superior quality of the skiing experience available in the South Island, which made it difficult for the North Island ski fields to attract international visitors and South Islanders.

South Island Ski Fields

35. 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 and Cardrona both located at Wanaka, have an estimated 85,000 and 110,000 skier-days per season respectively. The Remarkables and Coronet Peak, situated at Queenstown have an estimated 60,000 and 150,000 skier-days per season respectively. The above figures were provided by the Applicant and confirmed as reasonable estimates by the NZ Ski Council.

36. 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.

37. Three of the South Island ski fields (Coronet Peak, The Remarkables and Mt Hutt) are all ultimately owned by Air New Zealand, and operate under the brand “nzski.com”.

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

Department of Conservation (“DOC”)

39. 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.

40. 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.

41. 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 visitors, including cafeterias, toilets and shelter.

42. 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")

43. 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 New Zealand Tourism Board. It also liaises with the media and Government agencies such as the Hillary Commission regarding all snow sport related activities.

Ngati Rangi

44. Ngati Rangi, are one of the local Iwi in the Ruapehu region, and are the Tangata Whenua of the southern and south-eastern regions of Mt Ruapehu, which covers part of the Turoa ski field. Ngati Rangi made a written submission to the Commission as well as providing an oral submission at the Commission's Conference on 19 October 2000.

45. At the Conference, Ngati Rangi stated that it objected to the sale of TSR to RAL for a number of reasons including:

    - Ngati Rangi opposed the granting of a license to any party without its involvement in the decision making process in regard to its ancestral estate;
    - Ngati Rangi is a key stakeholder in the Ruapehu region;
    - the area upon which Turoa ski field is based is subject to a Waitangi Tribunal claim, submitted on behalf of Ngati Rangi; and
    - Ngati Rangi believes the Crown should purchase the TSR facilities for Ngati Rangi.

46. The Commission notes that its jurisdiction and decision making in respect of this Application is confined to the three options in section 67(3) of the Act (refer para 8-10).

Ngati Tuwharetoa

47. Ngati Tuwharetoa are the other local Iwi in the Ruapehu region. Ngati Tuwharetoa were given interested party status, provided the opportunity to make a submission on the Application, and invited to appear at the Conference. However, the Commission did not receive a submission from Ngati Tuwharetoa.

Regional Development

48. A number of the submissions have stressed the importance of the proposal to the Ruapehu region, if the proposed acquisition proceeds. The Commission heard that it would enable successful marketing of the region to overseas customers, increasing the number of international visitors, and as a result encourage local development, and produce numerous benefits to the whole regional community. These include oral submissions made at the Conference by Mayor Weston Kirton, of the Ruapehu District Council; Mr Chris Ryan, Chief Executive of the Ruapehu District Council; Mr Dave Scott, from Ohakune 2000; and Mr Garrick Workman, owner of the Hobbit Motorlodge in Ohakune.

49. The Commission has noted these views, and these matters have been discussed more fully in the Public Benefits section.

Recent Ski Industry Developments

50. 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 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. The 2000 season has been a successful season throughout New Zealand with average overall snowfalls, although until heavy falls in late August there were concerns that the season would be another poor one.

51. 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 advances 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.

52. Another development facing the ski industry has been the changing nature of demand. A qualitative analysis of the demand for skiing in the US suggests that demand has not kept pace with growth in the population: between 1980 and 1999 the US population grew by 19%, but skier-days were 51 million in both years. This is attributed to unfavourable demographic shifts, increasing competition from alternative leisure activities, and decreasing "commitment to the sport" by skiers.[2] This article further notes a 27% decrease in the average number of days spent skiing on vacation

[2] "It's a Different World Out There", *NSAA (The National Ski Area Association –USA organisation) Journal* August/ September 2000.

in 1970 compared to 1999 as being attributable to a core consisting of "older participants with less time, more options and decreasing commitment".

53. The New Zealand ski industry is also facing similar challenges in retaining skiers, and attempting to expand the skier base in New Zealand. Many industry participants advised the Commission that snow sports face competition from many other activities, including other leisure activities, and holiday travel to warmer destinations during the winter months. This issue is further discussed later on in this report.

Decision 357

54. 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. On 14 June 1999, the Commission declined to give clearance for the proposed acquisition.

THE RELEVANT MARKETS

Introduction

55. 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 in question, and in which the application of section 47(1) of the Act can be considered.

56. 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."

57. Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,[3] and in the Commission's *Business Acquisition Guidelines* ("the Guidelines").[4] A brief outline of the principles follow.

58. 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.

59. A properly defined market thus includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away

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[3] (1991) 4 TCLR 473.
[4] Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

(‘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 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.”

60. 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.

61. The Commission acknowledges that with most markets the defined boundaries will be blurred. For example, there may be some buyers who view other products outside of the defined market as being substitutable for the ones inside that market when a *ssnip* is introduced, even though for the great majority of buyers that would not be the case. This situation in itself would not provide grounds for broadening the definition of the market. A substantial proportion of buyers would have to respond to a *ssnip* by switching to those alternative products for those products to be regarded as falling in the same market.

62. For the purposes of illustrating this point, both the Commission and the Courts have in the past considered whether gas, electricity, and other energy forms are sufficiently close substitutes that they fall within an “energy product market”. The evidence suggests that while some users clearly do consider that these forms of energy are substitutable, and might shift between them in response to a *ssnip*, the bulk of users do not. Thus, both the Commission and the Courts have recognised that while inter-fuel competition provides some constraint on each energy form, this was not considered a sufficiently strong constraint to include electricity and gas in the same market.[5]

63. Likewise, in *New Zealand Rugby Football Union* (Decision No. 281, 17 December 1996) the Commission was required to identify whether the relevant market was for the acquisition of rugby union and rugby league player services, or whether those services were part of a broader market covering the acquisition of sports player services generally. The Commission found that while there may be some substitution at the margins, it was not satisfied that the relevant product market would not be so broad as to include all sports players.

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[5] *Power New Zealand Ltd v Mercury Energy Ltd and Commerce Commission* [1996] 1 NZLR 686.

Market Definition

Introduction

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

Product Dimension

65. In Decision No. 357 the Commission found that the relevant product market was that for the provision of downhill skiing and snowboarding services. This mirrored the approach taken by the Commission in the 1994 *Sepco* case,[6] the first that it had considered in the skiing industry, except that snowboarding was not then included. In the later Decision, snowboarding was included with skiing, partly because there is generally no significant differences in the services provided to the two activities by ski fields, and partly 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.

66. The product market definition is taken to include not only the field itself, but also the associated facilities and services such as lifts, ski patrolling, ski school, and snow making and grooming. 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).

67. In the 1999 case, RAL had 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, and the time needed to acquire the necessary skills—were such as to differentiate it significantly from other winter leisure activities, such that they were not close substitutes.

68. In this Application, RAL stated that it still considered that it operates in the wider winter leisure activities market, but rather than argue the point, it accepted the Commission's previously adopted product definition of the market. However, it contended that the competitive pressure from other leisure services should be treated as a constraint on that market. In its submission to the Commission after the Draft Determination, the Applicant again did not argue that skiing operates in a wider winter leisure activities market, but stressed that those leisure activities do provide a considerable constraint on a ski field operator's behaviour. At the Conference the Applicant submitted that while RAL considers that commercially it operates in a wider leisure services market, it accepts the Commission's product definition as the appropriate one for the purposes of assessing this Application.

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

69. The view favouring a wider winter leisure activities market was supported by a number of other submissions. For example, Mr Gary Traveller ("Mr Traveller"), the Receiver for Turoa, stated that one of the reasons for the introduction of the heavily-reduced $199 season pass at Turoa this year was to tempt people back to skiing from other winter holiday destinations such as Fiji, Rarotonga and the Gold Coast. Similarly, Mr John Cooper ("Mr Cooper"), of Tourism Business Solutions, stated that the ski industry is acutely aware that there are alternatives to skiing, and that the industry views those alternatives as real competitors. He added that the number of those alternatives has increased dramatically over recent years.

70. A number of other submissions stated that the consumer has a wide choice of activities to choose between, of which skiing is just one. Mention was also made of other promotions in the market place that compete for the consumer's spending of discretionary dollars, for example, such as that for season passes to attend rugby matches at the new sports stadium in Wellington. Others suggested that if the pricing of skiing were to increase, or the quality to decrease, then many skiers would switch to various other leisure activities.

71. While the Commission acknowledges that people do have a wide range of choices for their discretionary spending on winter leisure activities, it considers on balance that these are not sufficiently close substitutes to make skiing part of a wider "winter leisure activities market". Skiing is by its very nature a relatively specialised sport that requires more time, effort, specialised skills and equipment than most other leisure activities. From the submissions received during the Commission's process it has not found any new evidence that is sufficiently persuasive to lead it to change its view on the product dimension of the market.

72. 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 across a range of dimensions, including the following: snow conditions; the reliability of the weather conditions; lift capacities relative to demand; ease of access; the terrain; the facilities available for skiers and snowboarders of differing abilities; the provision of ski-related and other amenities; and the associated resort facilities.

73. 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. Skiers are said to crave variety and new skiing experiences. Moreover, the South Island ski field operators view the Mt Ruapehu fields as stimulating an interest in skiing in the larger North Island population, with those who reach intermediate skill levels then being more likely to travel further afield to ski in the South Island. Skiers may also be attracted by the resort facilities offered in the South Island, Queenstown in particular, the North Island does not offer anything similar. Further, a number of skiers travel to experience skiing in Europe, the United States or Canada where the scale and variety of ski fields and ski resorts is often very much larger than those in New Zealand.

Conclusion on Product Market

74. In conclusion the Commission accepts that if the proposed acquisition is to proceed, the combined entity will face some constraint from other winter leisure activities, but it does not consider that that constraint to be sufficiently strong to include these activities with skiing in a wider winter leisure activities market. Hence, the Commission concludes that the relevant product market is that for the provision of downhill skiing and snowboarding services.

Geographic Extent

75. 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 available are the club fields of Tukino on Mt Ruapehu and Manganui on Mt Taranaki, but their capacities and facilities are very limited, and they cater mainly for club members.

76. Given the geographic 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. When one of the fields is closed due to inclement weather, skiers find it relatively easy to, and do, drive to the other field to ski that day. Skiers typically are highly mobile, as is evidenced by the fact that many of them travel a considerable distance from either Auckland or Wellington to ski, sometimes only for a weekend.

77. The pricing and other behaviour of the two ski fields also supports the view that they are competing within the same geographic market. 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 followed suit, apparently within four hours of learning of the change. 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 cooperating in an attempt to expand the size of the market to their mutual benefit.

The Initial View of the Applicant

78. In its Application RAL did not dispute that the two Mt Ruapehu ski fields fall in the same geographic market. Rather, it based 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 contended that the more days in an intended ski trip, the more likely it was that those skiers would be prepared to travel greater distances and incur greater transport 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 argued that short stay North Island skiers are "captive" to the Mt Ruapehu ski fields, in that they generally do not look beyond the skiing options available on that mountain, from which it follows that for that group the geographic market must be limited to the North Island. RAL claimed 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.

79. RAL went 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 contrasted 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 supported this view by equating three day trips with "long weekends", and contended that such trips are more akin to extended than to short stays. The Applicant cited 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 over time with economic growth, particularly of high income earners), thereby raising the affordability of short trips to the South Island. This, it claimed, was reflected in the apparently increasing advertising in Auckland newspapers of "short break" ski packages to destinations such as Queenstown.

80. The Applicant also provided a number of examples of package deals being offered for ski trips to the South Island from both Wellington and Auckland, on a three day/two night and a seven day/six night basis. These package deals provide air travel, ski passes, accommodation and, in most cases, the use of a rental car or shuttle bus. In addition, the Applicant provided its own estimates of costs that a skier from Auckland or Wellington would incur on a skiing trip of similar duration to the Mt Ruapehu ski fields. On the basis of comparing these trip costs, the Applicant argued that the time and cost of travelling on trips to the South Island may not always be significantly more onerous than for those trips to the Mt Ruapehu ski fields. This was said to support RAL's view that skiing trips by North Islanders to Mt Ruapehu were interchangeable with trips to the South Island, implying that the two fell within a national market.

81. The Applicant also referred to a 1999 survey of South Island ski fields by CM Research, which found that 44% of the domestic skiers at those fields were North Islanders. It also argued that the extended stay category included 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.

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

83. On the basis of these various arguments, the Applicant concluded that there was likely to be 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),[7] and a national market for "extended stay" (and all overseas) skiers.

[7] 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 Initial View

84. In its Draft Determination, the Commission took 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.

85. 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, or had remained the same. In short, if a *ssnip* were to be introduced by the two Mt Ruapehu ski 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?

86. 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.[8]

87. 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 considered 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 stated that ". . . it is unlikely that a significant number of people would go to another field *on that basis alone*." (emphasis in original)

88. 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

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[8] 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.

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 by a significant amount for a significant period of time. Both RAL and TSR are suppliers of downhill skiing and snowboarding services only. They do not supply most of the other services, such as transport and accommodation, that 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 recognised 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 focused primarily on the potential ability of that entity to discriminate between different categories of skiers in the prices of lift passes.

89. To define the market as the Applicant advocated 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.

90. On this basis, the Commission concluded 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. In the Draft Determination (paragraph 64), the Commission noted the conclusion of the Applicant that the amount of switching between North and South Island fields in response to a *ssnip* as defined is unlikely to be significant.

91. In its Draft Determination, the Commission's view that the market is a North Island one was 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 the sales of season passes, according to RAL. In an interview with Commission staff, Mr Cooper, the General Manager of Treble Cone ski field, had commented that it was too early for ski operators in the South Island to assess whether the $199 season passes had had an impact on the number of North Islanders skiing in the South Island. He said that all of the South Island operators would be reviewing their figures to see if there had been a change in skier behaviour. However, the Commission notes that there has been no response in terms of a reduction in the lift pass prices of the South Island ski fields during the season. If such a large price reduction—albeit on season passes only—had had no impact, the much lower price increase associated with a *ssnip* could not be expected to have any impact.

92. 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. However, the Commission has been told that this was aimed at the local Nelson skiers, and apparently caused no reaction by either RAL or TSR (or other South Island ski fields) 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.

93. As mentioned above, RAL's Application provided costings of ski trips undertaken by North Island skiers from Auckland and Wellington, as shown in Table 1. The Applicant did not subsequently provide any further information that would suggest additional or cheaper packages had since become available. The figures supplied by the Applicant are based on three day/two night and seven day/six night excursions to Mt Ruapehu, to Mt Hutt in Canterbury, and to Queenstown. Trips within the North Island assume the use of a person's own car, and those between the Islands are based on the advertised package deals promoted by various travel wholesalers, which include air travel, accommodation, ski passes and, in general, the use of a rental car or shuttle. The Applicant used 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 appeared to underpin 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

94. In its Draft Determination, the Commission stated that these costings tended to overstate the costs to North Islanders of visiting the North Island fields relative to visiting the South Island fields on two grounds, both relating to car costs on North Island trips. First, the Applicant assumed 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 flights 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, included all of the "fixed costs" as well as the "running costs", giving a rate of 75.1 cents per kilometre. However, the

Commission took 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.[9]

95. The Commission then undertook its own revised 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 reflects variations in the costs of different classes of accommodation. The Commission did not receive any submissions that questioned whether these were the correct figures to use in estimating the ski trip costs within the North Island.

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
3 day	$239-314	$199-246	$197-297	$157-204	$229-319	$193-223	$226-316	$191-211
7 day	$548-758	$501-618	$506-716	$459-576	$538-748	$496-566	$535-745	$493-563

96. In Tables 3 and 4 the Commission has brought together the cost of skiing trips for skiers in Auckland and Wellington, including both trips to the South Island fields using the Applicant's packaged ski trips estimates from Table 1, and trips to Mt Ruapehu using the Commission's own costings from Table 2. This enables comparisons to be made between the costs of trips of similar lengths from those two cities to the ski fields in both Islands. Table 3 gives the total trip costs per person, whereas Table 4 provides the same information in terms of the cost per person per-day.

[9] 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 3
A Comparison of Ski Trip Costs Per Person from Auckland or Wellington to the North and South Island Fields

Length of Stay	South Island Ski Fields		North Island Ski Fields			
	Auck/Mt Hutt	**Auck/Q'town**	**Auck/Whakapapa**		**Auck/Ohakune**	
	1 pax	*1 pax*	*2 pax*	*4 pax*	*2 pax*	*4 pax*
3 days	$589-743	$744-911	$229-319	$193-223	$239-314	$199-246
7 days	$1,439-1,481	$1,053-1,409	$538-748	$496-566	$548-758	$501-618
	Wgtn/Mt Hutt	**Wgtn/Q'town**	**Wgtn/Whakapapa**		**Wgtn/Ohakune**	
	1 pax	*1 pax*	*2 pax*	*4 pax*	*2 pax*	*4 pax*
3 days	$479-635	$620-787	$226-316	$191-211	$197-297	$157-204
7 days	$809-1,172	$929-1,285	$535-745	$493-563	$506-716	$459-576

TABLE 4
A Comparison of Ski Trip Costs Per Person Per Day from Auckland or Wellington to the North and South Island Fields

Length of Stay	South Island Ski Fields		North Island Ski Fields			
	Auck/Mt Hutt	**Auck/Q'town**	**Auck/Whakapapa**		**Auck/Ohakune**	
	1 pax	*1 pax*	*2 pax*	*4 pax*	*2 pax*	*4 pax*
3 days	$196-248	$248-304	$76-106	$64-74	$80-105	$66-82
7 days	$206-216	$150-201	$77-107	$71-81	$78-108	$72-88
	Wgtn/Mt Hutt	**Wgtn/Q'town**	**Wgtn/Whakapapa**		**Wgtn/Ohakune**	
	1 pax	*1 pax*	*2 pax*	*4 pax*	*2 pax*	*4 pax*
3 days	$160-212	$207-262	$75-105	$64-70	$66-99	$52-68
7 days	$116-167	$132-184	$76-106	$70-80	$72-102	$66-82

97. The comparisons in Tables 3 and 4 indicate that ski trips from Auckland or Wellington to Mt Ruapehu cost much less per person, or per person per day, than to the South Island ski fields. For example, the cost per day of a three day package trip from Auckland to Mt Hutt ranges from $196 to 248, whereas a trip from Auckland to Whakapapa ranges from $76 to 106. For a seven day package trip from Auckland to Queenstown the daily rate ranges from $150 to 201, whereas a trip from Auckland to Turoa ranges from $78 to 108. This in itself would tend to suggest that the fields in the two Islands fall into different geographic markets. If the Commission could assume that both the North Island and South Island ski fields were identical in quality,

so that differences between the two groups of fields were purely price-based, then North Islanders would not switch to skiing in the South Island in response to a *ssnip*.

98. The Commission had also been advised, and accepts, that currently a number of North Island skiers choose to ski in the South Island each winter season, 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 1995 Survey 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 tended to suggest that Whakapapa and Turoa are closer substitutes for each other than they are for the South Island fields.

99. For each year since 1997, Tourism New Zealand has conducted research on visitor numbers to the five major South Island fields. From that research it has estimated the number of North Islanders who have skied in the South Island was as follows: 1997 – 23,320; 1998 – 19,361; and 1999 – 25,410.

100. The Commission must presume that those skiers perceive some additional benefit or value out of skiing in the South Island, because it is apparent that those skiers are paying a large premium to do so. RAL, in its submission, stated that people are prepared to travel to the South Island even though it costs more to do so, and fields may be slightly more expensive, because of the perceived quality differences in some South Island fields. It also states that the current differentiation for North Island skiers between the cost of North Island and South Island skiing reflects the market's assessment of value, and that this relative difference in value perceived by the Commission in the Draft Determination does not place the ski fields themselves in different markets.

101. However, the Commission could not agree, and in its Draft Determination concluded that the geographic market was limited to the North Island.

<u>Survey Evidence</u>

102. After the release of the Draft Determination the Applicant commissioned NFO CM Research to undertake an independent survey to identify likely skier behaviour ("the September 2000 survey"). The survey covered skiers aged 18 and over, and was undertaken at both the Whakapapa and Turoa ski fields between 11.00am and 2.00pm on 10-11 September 2000 (a Sunday and Monday). A sample of 441 was chosen, of which 90% (398) agreed to be interviewed.

103. The 32-question questionnaire included questions on the respondents' skiing trips that they had made, or intended to make, during the 2000 season. The aim appeared to be to elicit views on the substitutability of the South Island ski fields with the Mt Ruapehu fields. However, the questions were not framed in terms of whether respondents would switch to the South Island fields if skiing at Mt Ruapehu became more expensive, which is the relevant question for testing geographic market definition. Hence, the survey produced little of value on the issue.

104. As the survey was used to support other aspects of the Applicant's case, the validity of the research method used has to be considered. Mr Esslemont, market research expert for Sutton McCarthy, submitted as follows:

> "The survey is deficient in the *sampling methods* used, in the *quality of the interviewers*, and in the *form of questions* used to predict reactions to changes." (emphasis in original)

105. He claimed that the method of sampling used introduced many potential biases, so that there was "no reason to suppose that the actual sample selected is representative of that universe (of current users)." He also referred to the fact that "poorly trained interviewers can seriously bias the results of surveys", and that the results could have been biased by the interviewers being ski field employees. He contended that the form of the key questions on the price sensitivity of skiers were poorly worded, did not elicit all of the relevant information, and were inadequate for estimating future behaviour. He concluded that "the methodology of the survey is fundamentally flawed", and that "in my opinion no reliance whatever can be placed on the survey as a basis for estimating the effect on ski field usage of changes in price or other conditions."

106. Mr Leach of NFO CM Research responded to Mr Esslemont's criticisms of the survey at the Conference. He emphasised that the survey had been carefully planned and executed within the constraints of the very limited timeframe allowed. The questionnaire had been pilot tested internally; the questions had deliberately been kept simple given the nature of the interviewers (who were ski field employees, but had received some training); an unusually high proportion of interviews had been monitored by trained supervisors; the response rate was unusually high by normal survey standards; and all questionnaires (rather than just a sample) had been subsequently checked. The survey had been undertaken within a period of five days, compared to the normal time required of six to eight weeks required. When asked what changes would have been made to the survey had a longer period of time been available, he said that the questionnaire would not have been changed, but that the sample would have been taken over a period of a week, rather than just the two days, to improve the representativeness of the sample.

107. At the Conference Mr Esslemont elaborated on his views after he had heard Mr Leach's presentation. He said that while NFO CM Research was a very reputable research company, and that the questionnaire survey used reflected industry practice and was suitable for exploring some issues, it was inappropriate for eliciting responses on the nature of the demand schedule. One major issue remained the probable bias in the sampling method used, as it relied on skiers present on two days only rather than for a whole week, it excluded those under 18 years of age, and would have captured a disproportionate number of frequent skiers. However, Mr Esslemont did state that the fact that the survey was conducted after the release of the Draft Determination would not have introduced any bias in the results. Also, although the use of RAL staff as interviewers was "bad practice", and would have been an obvious possible source of bias, the effect was not likely to have been serious.

108. Having considered the various arguments for and against the survey, the Commission has come to the conclusion that while the attempt to use a survey to estimate the characteristics of skier demand was a laudable one, it cannot place much weight upon the results of the survey in question. While surveys are potentially a powerful research tool, the doubts raised by the impact of the time constraint on this occasion was so severe as to have the probable effect of preventing reliable results from being

generated. This conclusion has ramifications for the analysis later in this Determination.

Applicant's Subsequent View

109. In its submission in response to the Draft Determination, the Applicant claimed that with the benefit of the September 2000 survey, there was evidence to show that a significant section of skiers regard the North Island and South Island ski fields as substitutes; that they would change allegiance from the Mt Ruapehu ski fields if prices rose by 5% to 10%; and would change allegiance if the quality of service declined. This was based largely on the following findings: that 28% of the respondents had considered skiing in the South Island this season; that 20% actually had or were going to ski there; and that skiers in general were highly price sensitive.

110. Although the Applicant did not question the Commission's revised estimates of costs for skiers travelling within the North Island, as shown in Table 2, it contended that skiing in the South Island is an available and realistic option for many North Island skiers. The Applicant also referred to written submissions from individuals and ski clubs, which indicated that those persons considered the South Island ski fields as an alternative to skiing in the North Island in respect of both cost and time.

111. The Applicant has also questioned the Commission's use of the *ssnip* test. While it agrees that a *ssnip* may not make a trip to Mt Ruapehu more expensive than a trip to the South Island in absolute terms, it argues that because a trip to Mt Ruapehu remains less expensive it does not necessarily mean that skiers will always choose it over the South Island. The Applicant submitted that value is an aggregation of price and quality and that the relative difference in value perceived by the Commission in its Draft Determination does not place the ski fields themselves in different markets.

The NZIER's View

112. The NZIER, acting as economic adviser to the Applicant, pointed out that examining degrees of substitutability among alternative ski fields is complicated by a number of factors including pricing, perceived value and quality, and that a ski lift pass represents only a part of the cost of a ski holiday to the consumer. It also contended that the substitutability of one ski field for another differs for different ski groups. It submitted that it is the relative size of these different groups, and their varying willingness to switch between ski fields in response to a *ssnip*, that should determine the relevant markets. The NZIER also referred to the September 2000 survey as evidence that 27% of respondents indicated that they considered skiing in the South Island as an alternative to Mt Ruapehu. It concluded that while the North and South Island fields may be complements for some skiers, for a significant number of others they appear to be substitutes.

113. NZIER's submission at the Conference changed from its original position. It accepted that the relevant geographic market was the North Island, but with a significant constraint provided by competition from the South Island ski fields. It was further submitted that there are other constraints provided by other recreation and leisure pursuits, and that these should be given due weight. On these grounds the NZIER suggested that while there could be a broader market than North Island ski field services, the attempt to use such a broader market would raise the issue as to exactly where the wider market boundary could be drawn.

Other Submissions

114. The Commission received a large number of submissions that mostly supported the assertion that the North Island ski fields are part of a national market. For example, Mr Cooper said that the South Island ski areas strongly market their products in the North Island, and do regard themselves as competing for North Island skiers. He said that the available South Island ski packages marketed in the North Island provide a competitive option for a significant number of skiers and are targeted at a range of different market segments. He remarked that although a premium is added to the cost of a South Island ski trip, this is accepted because of the additional excitement factor of travelling by plane, and the fact that the destination is Queenstown and not Ohakune. Mr Cooper stated that although such a premium is currently acceptable, there are very definite limits on how much of a premium some people will pay.

115. Mr Peter Sutton said that he was not restricted to skiing in the North Island because he lives there, and that he makes his decision as to where to ski after assessing the ski conditions, although he admitted that he had not skied in the South Island for three years. He added that if there were price increases in the North Island he would move his skiing activities elsewhere; he would consider skiing not only in the South Island, but also the option of skiing in Canada or the USA.

116. Mr Paul Ridley-Smith stated that he is an advanced skier of 25 years standing, and had skied at most of the major ski fields in the country. He said that if the prices at Mt Ruapehu were to increase or the levels of service were to decrease, skiers would choose to ski elsewhere, or alternatively, not ski at all. The offer of a good package deal at Mt Hutt for two or three days might lead him to choose to take that trip in lieu of skiing those days in the North Island.

117. Mr Paul Goldfinch, the President of the Havelock Ski Club, wrote to the Commission in support of the proposed acquisition. He submitted that members of the Havelock Ski Club can, and do, consider ski holidays to the South Island, particularly for extended ski trips. He said that South Island visits are typically for 7-10 days of skiing. However, he also stated that because the lift pass component of a ski trip is less than 20% of the total cost of a trip, even a 10-20% increase in lift pass prices would have the effect of increasing the total cost of a trip by only 3-5%. He said that this in itself would be unlikely to affect his family's decision to go skiing for a weekend in the North Island.

118. Ms Joan Norrie, the President of the Rotorua Tramping and Skiing Club, also supported the proposed acquisition. She said that although some of its members do ski in the South Island, the current travel costs and higher lift pass prices associated with skiing in the South Island are a disincentive to travel to ski there.

119. In his submission opposing the proposed acquisition Mr W H Smith, a Wellington resident, submitted that South Island ski fields are not economic substitutes for Whakapapa. Mr Smith stated that while his family can drive to Whakapapa in four hours on half a tank of diesel, his alternative in the South Island is either to purchase four airfares, or four passenger and one vehicle ticket on the ferry. He also compared the accommodation costs that his family would face between those alternatives.

Sutton McCarthy's View

120. Sutton McCarthy submitted that the geographic market is substantially limited to the North Island, and noted that the RAL 1993 Annual Report stated that in excess of 95% of Whakapapa's skiers are resident North Islanders.

Conclusion on Geographic Market Definition

121. The most substantial argument raised by the Applicant was that there is extra value to North Islanders from skiing in the South Island, and that as a result they will be prepared to pay more for a trip to a South Island ski field. This raises the issue as to what extent that might provide a sufficient offset to any increase in lift passes in the North Island to cause sufficient skiers to respond to a *ssnip* by switching to the South Island ski fields.

122. The Commission's view is that based on the figures in Tables 1-4, the application of a *ssnip* to the lift pass cost component, being a relatively small dollar amount, is unlikely to make a material difference to the overall trip cost differentials revealed by the comparisons in the Tables. For example, on a proposed seven day ski trip to Whakapapa from Auckland, a rise in the day lift pass by 10% (approximately from $54 to $60) would cause the total cost of the trip to rise by only about $6 per day, or $42 in total. That increase is comparatively insignificant when compared with the current additional cost per day of between $109-129 for a skier from Auckland to visit Mt Hutt rather than Whakapapa. On this basis, it is extremely doubtful that a $6 per day increase in the Whakapapa day lift price would lead to a significant number of North Island skiers switching to the South Island ski fields.

123. This comparison supports the Commission's view that for North Island skiers, the South Island fields are not close economic substitutes for the North Island ski fields, and therefore do not fall within the same geographic market. A similar result is obtained if one compares the same costs for a proposed three day ski trip. These comparisons together, indicate that for both short stay and extended stay ski trips, the South Island is not an economic substitute to the North Island ski fields for residents of the North Island.

124. The Commission was told that research suggests there are about 180,000 skiers and snowboarders living in the North Island, although not all of those can be considered active skiers who would ski each year. Given that it is generally recognised that the South Island fields are able to provide a superior skiing experience than the North Island, there must be some reason as to why on average only 22,697 North Islanders have skied in the South Island in each of the past three years.

125. Many submissions stated that people do consider the South Island ski fields as an economic substitute to the North Island fields. The Commission produced its own trip costings which, as indicated, did not support that assertion. The Commission requested comments on these calculations (including car mileage rates and ski holiday packages), but neither the Applicant nor any other person at the Conference challenged the Commission's calculations nor commented upon them. These calculations resulted in the finding that skiing in the North Island is significantly cheaper than skiing in the South Island.

126. In conclusion, the Commission accepts that a hypothetical monopolist in the North Island ski market would face some constraint from the South Island ski fields, but it

does not consider that that constraint would be sufficiently strong to justify including North and South Island ski fields in the same geographic market. The imposition of a *ssnip* would not cause a significant number of North Island skiers to switch to the South Island ski fields. On the basis of the preceding analysis, the Commission concludes that the relevant geographic market is the North Island.

Functional Dimension

127. 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.

128. 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

129. 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.

Other Markets

130. 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 equipment hire and sales, the provision of food and beverages, a creche, and a chains fitting service. The Applicant considered that such services as these fall into separate product markets. It argued 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.

131. The Commission believes that market power concerns are unlikely to be raised if the proposed acquisition were to proceed. For example, there are many places at which skiing and snowboarding equipment 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.

132. The Commission has not received any submissions that have expressed concerns about these other markets.

Conclusions on Market Definition

133. 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”).

COMPETITION ANALYSIS

Overview

134. 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.

135. 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…”

136. 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.

137. 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.

138. 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.

139. 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)

140. 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

141. 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.

142. 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.

143. 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 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 5.

TABLE 5
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%**

144. On the basis of the above figures, the combined entity's market share would fall well outside the Commission's "safe harbours" (refer Commission's *Business Acquisition Guidelines 1999*). 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 from Existing Competitors

145. 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.

146. 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".

147. 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 "complementary" 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.

148. 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.

149. 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 from Existing Competitors

150. 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 from Potential Competition

151. 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.

152. 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

153. 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

154. 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.

155. 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

156. 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.

157. Based upon the information supplied by DOC, it appears unlikely that DOC will issue ski field extensions or new ski field licences for Tongariro National Park. 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".[10]

158. 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.

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

Regulatory Requirements

159. 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.

160. 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.

161. 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

162. 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.

163. 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.

164. 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.

165. 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.

166. 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

167. 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.

168. 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.

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

Excess Capacity

170. 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.

171. 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).

172. 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

173. 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 from Potential Competition

174. 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.[11] The constraint imposed by potential entry is assessed against the *lets* test.

Likelihood of Entry

175. 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 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.

176. 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.

177. 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

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

179. 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.

180. 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

181. 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.

182. 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

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

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.

183. 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

184. 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.

185. 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 Competition

186. 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.

187. 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.

Internal Constraints

189. RAL submitted that as a result of its unusual corporate structure the Company has significant internal constraints that would serve as an effective limit on the exercise of market power of the combined entity. In particular, the Applicant considers that its constitutional objects, tax status, and the Trust render RAL different to an ordinary corporate structure, and leave RAL with constraints that could be likened to those which may exist to a co-operative entity.

190. RAL submitted that the Trustees, being the only significant shareholder in RAL, are able to exert significant influence in the appointment of Directors, the maintenance of the objectives of the Trust and the current objectives of the Company. In fact, RAL submit that the Trust is bound to act in accordance with its own Deed and to ensure that RAL adheres to its own Constitution.

191. RAL submit that if the Directors were to act in a fashion inconsistent with the purposes of the Deed or the Constitution of RAL then the Trustees, as the significant shareholder, could remove Directors by way of ordinary resolution, appoint new Directors, or vote against the reappointment of Directors at the Annual General Meeting.

192. RAL stated at the Conference that the presence of the Trust would act as an internal constraint on the combined entity's behaviour. Its reasons for this is that the four-member Trust, with its block of 45% of the voting shares, is required by the Trust Deed to:

- promote skiing and other forms of sport and recreation on Mt Ruapehu;
- preserve the tax free status of the company; and
- promote the well being of the company, in relation to those objectives.

193. Sir John Ingram, one of the Trustees, said at the Conference that should any of the Company's actions breach the Trust Deed, the Trustees could not avoid taking action. However, in response to a question, he said that there had not been any instances where the Trustees had used their voting power to remove Directors or discipline staff following a change in direction of the Company.

194. The Applicant has argued that the ability of the Trust to act in this way would provide an indirect discipline upon the Company. The Commission notes that the fact that this potential power has never been utilised may reflect the fact that it had not needed to be, as RAL has been constrained by the competition from TSR. In any event, the Commission believes that even if the combined entity were to be constrained by the Trust, it does not follow that the outcomes would mirror those that would be expected to flow from competition.

195. In previous applications the Commission has examined the extent to which the ownership structure in co-operative companies can provide a constraint on the exercise of their market power. A number of those decisions have been reviewed by the High Court, in particular, *NZ Co-op Dairy Ltd v Commerce Commission* (1992) 1 NZLR 601 and *Ravensdown Corp Limited v Commerce Commission* 9/12/96, Panckhurst J and Prof Lattimore, HC Wellington, AP 168/96.

196. The Commission and the Courts have accepted that suppliers to a co-operative, ie. the shareholders, can be in a position through their ownership of the company to prevent, or at least curtail, the exercise of any power which would be against their interest. In *NZ Co-op Dairy Company Limited* the Court held, at page 629,

> "we are quite satisfied on the evidence that was before the Commission that by a system of committees, meetings and the appointment of Directors, the suppliers have a very effective day to day influence on a decision making processes of their Dairy Company Co-operatives and would have just such a strong influence on the merged company. When the constraints of the Dairy Board Act and the Milk Act are added to that situation our view is that, despite the cost advantages it will acquire, the merged company will still be somewhat constrained by its co-operative structure from behaving "to an appreciable extent in a discretionary manner without suffering detrimental effects." in the raw milk market."

197. In *Ravensdown,* which involved a different co-operative structure to that in *NZ Dairy Co-op,* the Court accepted the Commission's conclusion that the co-operative structure may provide some constraint upon the exercise of market power. The Commission was not satisfied that the co-operative ownership was likely to prevent *Ravensdown* assuming a dominant position in the relevant markets. At page 34 of the decision the Court held,

> "we agree with the conclusion that the number of shareholders *Ravensdown* had and their geographical spread, render it much less likely that shareholder influence will operate as a significant constraint on the company."

198. The Court also considered the behaviour of the co-operative company in its pre-merger form and accepted that competition with other firms was a major reason for downward pressure on prices, and not simply the co-operative nature of the *Ravensdown* company.

199. At page 35 the Court stated,

> "a further striking area of evidence was that from *Ravensdown* shareholders concerning the scope to influence company policy making and the performance of a co-operative's management with, and without, competition. Several submissions were received which demonstrated that the *Ravensdown* board did take important policy decisions without reference to shareholders."

200. The Commission has considered the above arguments, and has reached the conclusion that the ownership and governance structure of RAL is a factor that can be taken into account. However, the Commission notes that there is a fundamental difference between a co-operative and the structure of RAL. RAL has 4,500 shareholders, of which approximately 50-60 attend the Annual General Meeting. In addition the shareholders do not have a day to day impact on the decision making process by RAL, and those decisions are not related at all to the livelihood of the shareholders. From the minutes of the Annual General Meetings supplied to the Commission, it is noteworthy that the Trust's shares were not voted upon at any of these meetings. As a result a vast proportion of the 180,000 North Island skiers that are not shareholders in RAL, have no direct say in how the Company is managed.

201. The Commission is of the view that the Trust, given the focus provided by the Deed, is more likely to stress the maintenance of some types of service quality, as against keeping prices at the competitive level. The reason for this is that 'high' prices may generate substantial profits that can be ploughed back into the field, thereby promoting the objectives set out in the Trust Deed. Mr Dave Mazey, the General Manager of RAL ("Mr Mazey") said at the Conference that lift pass prices were "at the upper end of what our market will bear", but Sir John Ingram thought that such prices were acceptable as this helped to provide funding for new facilities, such as the recent provision of a creche at Whakapapa. As the Trust is required to promote winter sports on Mt Ruapehu, this could lead to a situation, for example, where unnecessary or unduly lavish investments, or excessive spending is made on facilities that would not be countenanced in a competitive environment.

Conclusion on Internal Constraints

202. The Commission accepts that there are incentives on the Company to maintain its objectives and current tax free status. The presence of the Trust to ensure those objectives and status are maintained are in contrast to an "ordinary" company. In effect, the presence of the Trust as the significant shareholder serves to doubly entrench the Constitution and tax free status of the Company, and therefore would provide some constraint. Further it can be assumed that there will be some constraint on the ability of the combined entity to act either in conflict with its current objectives or to forego its tax free status, but the Commission is not satisfied that these factors are likely to provide an effective constraint on the behaviour of the combined entity to alleviate dominance concerns.

Other Competitive Constraints

203. The Commission received a number of submissions regarding factors that would provide a competitive constraint on the combined entity. These were highlighted as: South Island ski fields; other leisure activities; skier expectations; and price equity. Although the Commission has considered that the relevant market is a North Island skiing market it accepts, as with all markets, that there are competitive pressures on the fringes of the market, which may provide a constraint on the combined entity, although these factors are not considered part of the relevant market.

South Island Ski Fields

204. 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.

205. The Commission received a number of submissions, and heard a range of views during the Conference, that some North Island skiers will travel to the South Island for their skiing experience. It was submitted that skiing in the South Island is an available and realistic option for many North Island skiers who can and do choose to ski in the South Island. It was submitted that skiing in the South Island is now affordable given the variety of skiing packages available. Further, it was submitted that a number of skiers choose to also ski overseas.

206. The Commission considers that if the South Island does provide an option to North Island skiers, it is only an alternative for some skiers. While the price of skiing holidays to the South Island is an attraction for certain skiers, it is still the case that skiing in the South Island remains considerably more expensive for North Island skiers, than skiing at Mt Ruapehu. Therefore, the decision to ski in the South Island is made for reasons other than purely price-driven, including factors such as the more reliable weather, and better snow conditions.

207. The Commission notes the poor skiing seasons of 1995, 1996 and 1998. If the premise that the South Island ski fields provide an alternative to North Island fields is correct, one may expect to see a marked increase in the number of North Island skiers skiing in the South Island in these seasons. The information collected by Tourism NZ, referred to earlier, suggests that for a large number of North Island skiers, the South Island ski fields did not represent an alternative to the North Island ski fields.

208. Therefore, on the basis of the information provided, the Commission considers that while the South Island ski fields provide some competitive pressure to the North Island, it would not provide an effective constraint upon the behaviour of the combined entity.

Other Leisure Activities

209. The Applicant has submitted that the providers of other leisure activities would also provide a constraint upon the combined entity. For example, the Applicant submitted that it considered the likely attraction of the rugby matches at the new sports stadium

in Wellington when evaluating its pricing options for 2000, as well as other activities such as winter holiday packages to South Pacific destinations.

210. The Commission received views during the Conference to the effect that, if the combined entity increased prices or reduced service levels, many skiers would choose to spend their money and time on other leisure activities.

211. However, the Commission considers that other leisure activities are not directly substitutable for skiing. The Commission recognises that while other leisure pursuits provide some competitive pressure on the skiing market, it does not consider this pressure sufficiently strong enough to include other leisure pursuits in the same market as skiing.

212. Therefore, the Commission considers that other leisure activities, while providing a degree of competitive pressure against the combined entity, is not of an extent to be considered an effective constraint upon the behaviour of the combined entity.

Skier Expectations

213. The Commission received a number of submissions regarding consumer expectations and demands. It was submitted that consumers today are much more demanding and expect a greater level of service, and will seek alternatives if their expectations are not met. Further, it was submitted that skiers are very knowledgeable regarding overseas trends and equipment, and as a result would expect a certain level of service and would demand improvements to facilities following overseas experience, and this would provide a constraint on the combined entity.

214. Mr Cooper submitted in support of RAL, that the skiing industry was driven by a much wider variety of market forces that a single regional competitor. Mr Cooper stated that a major factor is skier expectations, skiing is an expensive activity and skiers demand value.

215. Both Mr Cooper and Mr Traveller argued that many skiing customers are quality sensitive. Peoples' general standards of quality reflect trends outside of skiing. People will not queue for ski lifts, just as much as they will not queue for anything else. Mr Traveller claimed that RAL's own shareholders would constrain the Company as the shareholders are also the customers.

216. The NZIER argued a similar point, noting that the vast majority of RAL's shareholders are active skiers, experiencing the services provided at first hand. The ski clubs based on the mountain were also influential. The NZIER claimed that the Board of RAL is sensitive to the views of all of these parties. It was submitted that a combined entity would not be able to retain its customers if it failed to provide the services and facilities that skiers expected and demanded from ski operators today. It said this was particularly important given the wide range of alternative winter leisure activities that are available, should people be turned away from skiing.

217. The Commission notes that a competitive environment allows consumers to exercise choice in a market, and consumers require options in order to give effect to their expectations. In this case, consumer expectations are heightened by perceptions of value and quality standards of the skiing experience that is offered. Skiers effectively have nowhere else to ski in the North Island, to be able to exert a significant constraint on the combined entity skiers need a choice. This they would be denied by the combined entity, which would have a virtual monopoly in the designated market.

218. Therefore, the Commission considers that skier expectations in isolation, while providing a degree of competitive pressure against the combined entity, is not of an extent to be considered an effective constraint upon the behaviour of the combined entity.

Inability to Price Discriminate

219. The Applicant and the NZIER claimed that as the combined entity would not be able to discriminate between competitive extended stay skiers and "captured" short stay skiers, it would be unable to exploit its market power over the former without losing the custom of the latter.

220. The Applicant contended 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 Whakapapa lift pass revenue in 1999 coming from sales of multi-day passes. This behaviour apparently reflected the variability in the weather conditions on the Mt Ruapehu fields, such that skiing cannot be guaranteed over a number of successive days.

221. However, the Commission notes that while this may have been true in the past, this has now changed and is reflected with the much greater popularity of season passes this season. As a result of the price discounting, season pass sales have come to occupy a substantial part of the business. Mr Mazey advised that the sale of season passes this year rose from 1,000, to 17,000. The Commission also notes that the Applicant implied in its public benefit claims 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. The Commission notes further that there is no suggestion that in the future, similar discounted passes will not be offered.

222. Sutton McCarthy submitted that it would be extremely easy for the combined entity to introduce differential pricing. Indeed, some prices already discriminate between different classes of customers, examples being mid-week passes, whole mountain passes, and beginners' passes.

223. 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 would not depend upon its ability or not, to discriminate between the two categories.

224. The Commission does not accept that the combined entity would be unable to price discriminate and therefore it is not considered as a constraint upon the behaviour of the combined entity.

Conclusion on Other Competitive Constraints

225. The Commission has given consideration to the possible factors that might constrain a merged entity from exercising market power in the North Island skiing market.

226. While the Commission considers that there may be some substitution at the margins for South Island ski fields, the Commission concludes that South Island ski fields do not provide an effective constraint upon the behaviour of the combined entity.

227. Similarly, the Commission concludes that other leisure activities, whilst providing a degree of competitive pressure, do not provide an effective constraint upon the combined entity. Further, skier expectations in the absence of competitive alternatives are not sufficient to constrain the combined entity.

228. The Commission does not accept that the combined entity would be unable to price discriminate and therefore it is not considered to be an effective constraint.

Conclusion on Dominance in the North Island Skiing Market

229. The combined entity will attain a market share well in excess of the Commission's "safe harbours". It will not face any effective constraint from either existing competition, or the likelihood of new entry. The internal controls arising out of the ownership and governance structure of RAL is not likely to impose a sufficient constraint on the behaviour of the combined entity.

230. Further, the Commission concludes that the combined entity will not be constrained by the South Island skifields, nor by the presence of other leisure activities. The Commission also concludes that skier expectations in isolation will not provide an effective constraint upon the behaviour of the combined entity.

231. The Commission does not consider that a combined entity would be unable to price discriminate, and therefore it is not considered to be a constraint.

232. 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 North Island skiing market.

PUBLIC BENEFITS AND DETRIMENTS

Introduction

233. 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 as set out above, the proposed acquisition cannot be cleared under section 67(3)(a) of the Act. The Commission must therefore consider whether the proposed acquisition can be authorised under section 67(3)(b) of the Act.

234. 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.

235. 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 Public

Benefit 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.

236. 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. A clear nexus has to be shown between the proposal and the claimed benefits, such that the same benefits could not be gained outside of the acquisition in question.

237. The Commission is also mindful of the observations of Richardson J in *Telecom*[12] 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. In his judgment in the same case, Casey J noted and concurred with the comments of Richardson J on that issue. The Commission's approach to the quantification of detriments and public benefits was supported by the High Court in the decision of *Ravensdown Corporation Limited v Commerce Commission and Ors*.[13] After referring to the above comments from the *Telecom case*, the judge stated:

> "We accept that the Commission did adopt an analytical framework from which it proceeded to an analysis of allocative, productive and innovative efficiency. We regard the use of such framework in the present case as a strength of the Determination. It was an approach which helped guard against the dangers of missing elements which required consideration on the one hand, and the double counting of elements on the other. Moreover, the framework as an economic model represented a mainstream approach suitable for the task in hand."

238. Later in its decision the Court said:

> "We have considered the quantitative assessment of detriments undertaken by the Commission. What is notable about that assessment is its transparency ... Where evidence was available to arrive at a quantitative assessment, that was done, but equally in the absence of sufficient evidence no endeavour to quantify in dollar terms was attempted. It is also significant that the analysis included both a separate examination of the benefit and detriment elements, followed by a more holistic exercise. In other words, the Commission considered the individual issues but then stood back and looked at benefits and detriments in the round. We are not persuaded the methods employed were inadequate or wrong."

239. The Commission thus believes that it should attempt to quantify detriments and benefits wherever feasible, always recognising that given the difficulties inherent in such quantification, it will usually only be possible to establish the range within which the actual value of a particular detriment or benefit is likely to fall. Judgement has then to be exercised to determine where in the respective ranges the outcome is likely to fall, this being part of the exercise of weighing the aggregate of benefits against the aggregate of detriments. It is also recognised that not all gains and losses can be measured in dollar terms, and that those of an intangible nature, which are not readily measured in monetary terms, must also be included in the assessment.

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[12] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429,447.
[13] Unreported, High Court Wellington, AP 168/96, 9 December 1996, Panckhurst J and Prof. R G Lattimore.

The Counterfactual

Introduction

240. 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.[14]

An Alternative Buyer of TSR

241. As the Applicant noted in its Application, 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 would be sought by the Receiver. It is unlikely that the Turoa ski field would be closed and the assets liquidated, as this would involve very substantial exit costs caused by the requirement under the DOC licence to return the environment to its original state. Hence, RAL has contended, and the Commission accepts, that the counterfactual is very likely to involve the sale of TSR as a going concern to another purchaser.

242. 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 [ ], and the other was from Sutton McCarthy. The Receiver has told the Commission in confidence that at the close of bidding the bids were as follows: [ ]. The Receiver has not been able to evoke serious interest from other ski field operators, either those overseas or in the South Island. The possibility of [ ].

243. On the basis of similar and other information, the Applicant considered 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. Subsequently, in its submission the NZIER, apparently under the misconception that the above characteristics were those identified and approved by the Commission, argued to the contrary that the alternative buyer could be characterised as one of the following: either a small company of New Zealand ski enthusiasts (the "enthusiasts model"), or a foreign national investor (the

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

"foreigner model"). This view appeared to be based on knowledge of the identities of the other two bidders.

244. In its submission and at the Conference, the NZIER argued that another buyer of TSR would probably have access to management of no more than average ability, implying that such management would be inferior to RAL's management. It was argued that another buyer's lack of experience in running a ski field operation would "inevitably carry over into the difficult task of identification and acquisition of an experienced and capable management team".

245. This argument was disputed at the Conference by Mr Sutton of Sutton McCarthy, who considered that no-one would make lightly such a significant investment in a risky proposition such as TSR. The Commission accepts that a potential purchaser will have considered the ramifications of its investment and, if successful with its bid, would take the actions necessary to ensure that its newly acquired operation would be able to compete effectively. In this context, the Commission notes that the industry appears to be a tightly-knit one in which some managers have had employment experience at more than one, and sometimes several, ski fields. For example, Mr Cooper, who gave evidence on behalf of RAL at the Conference, has managed most of the South Island fields at one time or another during his career.

246. Sutton McCarthy agreed with the Commission's position as set out in the Draft Determination, namely that TSR will be sold as a going concern to a new ski field operator. In its submission, it argued that a new operator would have the benefit of several factors: access to experienced TSR staff; ability to attract additional management resources, as required; access to diversified sources of funds (unlike RAL); would have paid less than RAL for the acquisition; and would have low or modest debt given the post-eruption risk perceived by investors. Sutton McCarthy also noted at the Conference that TSR has been managed this season by a Receiver with no prior ski field management experience, and that there has been no suggestion that he has done other than a very good job.

247. Mr Traveller, the Receiver, responded to Mr Sutton's comment by noting that the investment decisions he had taken this season had not been difficult ones, and had been motivated by the immediate need to protect Turoa's revenue stream in the 2000 season (although the Commission notes that this had involved persuading the bank that had placed TSR in receivership to invest a further sum of [ ] in the business). However, he said that the facilities at the field were run down, so that much more investment would be needed in the future. Some big and difficult decisions would have to be made at that time. In addition, the operating conditions on Mt Ruapehu were unusually harsh. He said that Doppelmayr (manufacturer of ski lift equipment) views Turoa as a test-site for the operation of its lifts, and considers that if the lifts work there, they will work anywhere in the world. These difficult operating conditions have financial ramifications.

248. After considering these various arguments, the Commission believes that the management skills required for successful ski field management are both generic and ski field-specific, and that the range of skills that would be required by a new owner would be available.

249. There was also discussion at the Conference as to whether an investor-owned company of Turoa could compete effectively against a co-operative company like RAL. Mr Traveller claimed that any future operator of Turoa would be at a

disadvantage to RAL because, unlike RAL, it would have to pay tax at 33%, together with dividends to the owners. Hence, it would retain a much smaller proportion of profits to plough back into the business than would RAL. This helped to explain how RAL had significantly better facilities than does Turoa. Sutton McCarthy responded to this argument at the Conference by questioning how long RAL's tax advantage would persist, as tax regulations could change, and by noting that while tax was a contingent item, dividends were a discretionary item. For example, the new owner of Turoa, if it were not RAL, might not pay any dividends in the first years of operation. He also contended that Turoa had apparently increased its market share during the 1990s, which was not consistent with the view that it was unable to compete with RAL.

250. The Commission notes that all of the South Island fields are investor-owned, and that until the difficult years of the mid-1990s, Turoa seems to have been profitable. However, it is understood that more than one of the South Island ski fields have been for sale for some time without attracting buyers. Also, a number of parties at the Conference commented on the fact that Turoa had had a succession of owners over the years, and that this lack of stability undermined the confidence that was needed for others to invest in the tourism business in Ohakune and surrounding districts.

251. The Commission is aware of the identities of the two alternative buyers to RAL. It agrees with the NZIER that new potential buyers are unlikely to come forward at this stage. [ ] a ski field like Turoa. While the alternative buyers may have less experience in operating a ski field on Mt Ruapehu than RAL, it would no doubt be able to draw upon the expertise of the experienced existing management and staff, it could employ additional management skills as required, and by definition it would have likely paid less for its acquisition than would have RAL.

Characteristics of the Counterfactual

252. A number of arguments have been put forward by the Applicant and others as to the nexus between the proposed acquisition and the claimed benefits. This raises the issue as to whether, or the extent to which, the benefits are achievable only with the proposed acquisition, or whether in fact they could be achieved, at least partially, under the counterfactual. This requires an assessment of the likely features of the counterfactual, and in particular, the extent to which the separately owned fields in the counterfactual could achieve by cooperation what the combined entity would be able to do unilaterally.

253. In the closing address for the Applicant at the Conference, Mr Sissons suggested that in assessing the likely commercial behaviour that would exist under the counterfactual, the best evidence is likely to be got from the history of the previous ownership of the Turoa ski field. During the course of its 25 year life it has had effectively four owners, all with varying ownership structures, and in that time there has been little or no cooperation, joint marketing and the like with RAL. He also pointed to the similar example in the South Island, where the two Wanaka fields—Cardrona and Treble Cone—would appear to have the same incentives to cooperate, and yet have not managed to do so. Mr Cooper supported this view, saying at the Conference that if the two Wanaka ski fields were under one ownership, they would be a far more compelling competitor than they are currently. Conversely, if the

Remarkables and Coronet Peak were under separate ownership they would be a far less effective competitor than they are now.

254. Mr Traveller also emphasised the difficulties associated with two competing ski fields cooperating. Ski fields earn their revenues over a three, and at best a four month period each year. Because of this, and the nature of marketing investments, he said that a cooperation arrangement may yield a return only after three or four years have elapsed. Also, the skier-day numbers at Whakapapa are probably 80% larger than those at Turoa. This degree of inequality in size makes it very difficult for the smaller party to feel that it is getting a fair share of the returns to which both are contributing.

255. Mr Cooper added that the high fixed cost structure of ski fields makes it essential to get in sufficient skiers during the season to cover fixed costs, and this compelling need could undermine good intentions over cooperation. He also said that Tourism New Zealand, through its experience in developing a range of operator groupings to promote tourism, had found that this was easier to do with parties not in direct competition with each other. The practical reality was that fierce competitors found it hard to cooperate. Mr Miles Davidson ("Mr Davidson") of NZ Ski Council noted that differences in the branding associated with each of the separate fields could cause problems in projecting a common brand image.

256. Nonetheless, the Commission points out that RAL and TSR did undertake a reasonably successful joint marketing campaign in Australia over the period 1993-95, and that one of the other bidders for TSR (Sutton McCarthy) has indicated a willingness to enter into cooperative arrangements with RAL, should its bid be successful. It may be that the prospect of commercial benefits will overcome the problems mentioned above, and that where cooperative ventures fail to materialise, the underlying problem may be more a lack of prospective returns rather than an inability to cooperate. However, where a venture would only be marginally profitable to a combined entity, it may well be that the presence of the transaction costs associated with cooperation would be enough to render it unprofitable.

257. There are three specific issues now to be considered: seamless (or joint) lift passes for the two ski fields; the proposed traverse to link the two fields; and the international marketing to attract overseas skiers to Mt Ruapehu.

Seamless Lift Passes

258. The Applicant has proposed that if the acquisition were to receive an authorisation, it would introduce a seamless (or joint) lift pass that skiers could use interchangeably on either ski field. It has stated that this pass would be sold pre-season for a price of $239, as compared to the single field season passes offered for $199 by both fields in the 2000 season. It has argued that such a pass would increase the value to, and therefore the numbers of, skiers on Mt Ruapehu. However, the issue is whether a seamless pass, or something akin to it, could be introduced in the counterfactual where both fields remain under separate ownership, or whether single ownership would be required.

259. Several submissions commented on the proposed seamless passes and the likely counterfactual. For example, John Goldsbury noted that he:

> ". . . would not ski any more days if the fields were jointly owned – it would make absolutely no difference . . . The much vaunted "seamless" lift pass would be a big plus but it is an entirely separate issue from joint ownership. A seamless lift pass could be achieved by co-operation between separate operators. Also joint ownership does not automatically guarantee seamless lift passes."

260. If attempts were made by separate owners to use a seamless pass, both parties would have to agree on its price and the basis for splitting the revenues earned. For example, an allocation could be agreed in advance (such as a 50:50 split, or one based on the relative sizes of the fields), or revenues could be divided according to actual patronage, which would necessitate a mechanism for monitoring and reconciliation. In addition to developing such a joint pass, the two parties might also need to market the tickets cooperatively. This would require a further agreement on the funding of the marketing, to avoid the potential for one to free-ride on the spending of the other.

261. The NZIER has noted that mechanisms to monitor use of joint passes at each field under separate ownership would be expensive. However, according to Sutton McCarthy, such monitoring could be achieved through use of the bar-coding technology currently employed at Turoa. He also tabled photocopied material at the Conference relating to skiing in the Breuil-Cervinia-Valtournenche region, which straddles the border between Switzerland and Italy. Here, passes are available giving access to all Italian and some Swiss lifts, which suggests that it is possible for ski field operators in different countries to cooperate over seamless passes.

262. An alternative approach which would offer a similar outcome was the endorsement method proposed at the Conference by Mr Sutton. The new owner of Turoa could offer a facility under which RAL season pass holders would be able to purchase a season endorsement which would allow them also to ski at Turoa. The endorsement could be either unrestricted as to its use, or, for a lesser payment, could be restricted to use on specific days (for example, Tuesdays to Thursdays). The endorsement could be sold directly by Turoa, or via RAL. This possibility was not rejected by RAL at the Conference. The Commission suggests that even if the endorsement scheme gave rise to problems of cooperation, they would surely be possible, at a minimum, on days when one field is closed and the other open, where the closed field would have little to lose by encouraging skiers to avoid disappointment by moving for the day to the other field.

263. In a submission prepared for RAL, Simpson Grierson suggested that the provision of a joint pass by separate owners of the two ski fields, and of fixing a common price for such passes, would, in the context of the Mt Ruapehu fields, carry a risk of breaching section 30 of the Commerce Act. Further, Simpson Grierson questioned the application of section 31 (exemption for joint venture pricing), and noted that:

> ". . . even if section 30 is not an issue, we are of the view that given the two fields are the only two competitors of any significance (assuming the Commission's market definition) and the likely popularity of seamless passes, the impact of co-operation is likely to substantially lessen the scope and intensity of the competitive activity between them."

264. Mr Sutton also noted that apart from the joint venture exemption potentially available under section 31, the authorisation process under section 58 provided another avenue to allay any concerns over price fixing or a lessening of competition as a result of a cooperative provision of a joint pass.

265. The Commission has given some consideration as to the likelihood and the legality of possible arrangements between separate owners of Whakapapa and Turoa. First, on the likelihood issue, the development of a new joint season pass would require a considerable degree of cooperation between the two ski field owners. The Commission understands that a form of joint pass was introduced by the two fields as part of their marketing campaign in Australia in the period 1993-95, but that this fell through when that campaign collapsed (see below). Other past experience suggests that cooperation between independent ski fields operators may be limited. For example, the Wanaka ski fields at Treble Cone and Cardrona have not developed a seamless pass offering access to both ski fields, nor has there been much cooperation to develop Wanaka as a skiing centre, despite the views of Mr Cooper that it was very much in their commercial interests to do so. This contrasts with the ski fields at The Remarkables and Coronet Peak, which have been effectively marketed under single ownership as part of the wider promotion of Queenstown.

266. The Applicant and others have emphasised that there are a number of impediments to such cooperation. According to the submission of Mr Cooper:

> "what makes this type of co-operation highly unlikely are things like:
>
> i. different corporate philosophies;
>
> ii. perceptions of free-riding by one party on the other;
>
> iii. perceptions of how one company might benefit financially to the detriment of the other;
>
> iv. difficulty reading agreement on pricing, allocation of revenue;
>
> v. costs associated with allocation of revenue solutions, which either tend to be technology driven, and therefore expensive or not customer friendly."

267. Mr Cooper said at the Conference that Cardrona and Treble Cone had joint passes some years ago, but that the scheme fell apart because of commercial pressures and uncertainties that each party harboured about the motivation and behaviour of the other. For example, there were difficulties over the reporting of numbers and statistics which formed the basis of the revenue split. For these reasons, he considered that seamless passes between independently-owned fields were very difficult to make happen on a regular basis.

268. The NZIER argued that the commitment of both parties was needed to overcome these sorts of difficulties, but that such commitment was difficult to build and to maintain. Once an arrangement was established, the incentives were liable to change, such that one party might seek to benefit by free-riding upon the efforts of the other. A high degree of trust was required between the two parties, which is difficult to achieve given that in other settings they are strong competitors.

269. If, nonetheless, a joint pass with separate ownership were to be introduced, it seems likely that that attempt would only be successful if the setting of terms, in particular of price, were to be coordinated by the two ski fields acting jointly. A field acting unilaterally would run the risk of undermining its position. For example, if Turoa were to offer RAL pass-holders an endorsement as described above, and RAL did not reciprocate, skiers would be likely to purchase the RAL season pass, and then use the additional endorsement to gain access cheaply to the Turoa field. In this fashion, the unilateral offering by Turoa of an endorsement would undermine sales of Turoa season passes, and in all probability reduce its overall revenues. However, endorsements for closed days would appear to pose few difficulties.

270. The second issue concerns the legality of a possible joint pass arrangement under the counterfactual. As noted, the parties would be able to apply to the Commission for a section 58 authorisation if they so chose. However, each of the various steps required would involve uncertainties, as follows:

- First, the arrangement would have to be agreed to by the parties.
- Secondly, the issue as to whether that arrangement would breach section 30 would have to be assessed, and only if that were regarded as being likely would the possibility of applying for an authorisation be likely to arise.
- Thirdly, the issue as to whether an authorisation should be sought would have to be considered, or whether, given the costs and the uncertainty of the outcome, the arrangement should be pursued.
- Finally, if an authorisation application were to proceed, the likelihood of its ultimate success would have to be considered.

271. Given these uncertainties, the Commission is of the view that the introduction of a joint pass by independent ski field operators would be less likely than it would be if the same fields were under single ownership.

The Traverse

272. The Applicant has stated that should the proposed acquisition be granted authorisation, it would introduce a guided traverse that would enable skiers on either field to ski to the other. There is no such organised traverse guiding service currently available, although it is understood that some skiers have undertaken the traverse on their own initiative under favourable conditions.

273. At a minimum, the traverse would allow skiers to ski from one field to the other, and to receive a single lift ride so as to enable them to regain the necessary altitude required for the return traverse. The Commission has considered whether the creation of the traverse under separate owners would be practicable, and whether the consequent pricing for use of that linkage would give rise to concerns under Part II of the Act. On the latter issue, the Commission is of the opinion that a genuine joint venture would create a *new* product. The joint venture partners would be entitled to fix a price that covered the costs involved in maintaining the traverse and any added value of access to the other field. Such a venture would appear not to give rise to concerns under the Act.

274. However, similar, although perhaps less severe, issues over cooperation between the separate owners would be likely to arise. Presumably, a special ticket would have to be issued. They would have to agree on the pricing of the single lift ride on each field, and also on how to share the costs of the guides (which under the Applicant's proposal, would not be charged for). There would also have to be some provision—presumably bus transport—to return skiers to their cars should an unexpected change in weather conditions prevent them from undertaking the return traverse trip.

275. A further matter is that while the prospect of making the return traverse would appeal to some skiers in its own right, other skiers have said that its real advantage would flow from its enabling skiers to ski on both fields during the course of a single day without having to descend from the mountain. However, that ability would depend upon the provision of a seamless lift pass which, as the Commission concluded above,

is less likely to be a feature of the counterfactual scenario than it would be with the proposed acquisition.

276. In summary, the Commission has come to the view that there would be likely to be no legal impediment to the introduction of the traverse under the counterfactual, but that some difficulties in cooperation would be likely to arise even in the simple case involving the return traverse, without there being any skiing on the other field. Nonetheless, separate owners might still find it possible to introduce such a traverse, even though it has not been done to date. Under the proposed acquisition the introduction of the traverse would be more likely, and its potential benefit to skiers would be more likely to be developed to a greater extent through the associated introduction of the seamless lift pass.

International Marketing

277. The Applicant has argued that one of the benefits from the proposed acquisition will flow from the greater ability of a single owner of the ski fields on Mt Ruapehu to market its facilities to overseas skiers, especially those in Australia. A "single destination" marketing campaign will be proportionately much more effective than the current marketing, where each ski field separately markets itself, mainly domestically and under its own brand name. This raises the issue as to what sort and level of overseas marketing might be expected in the counterfactual, with Turoa under new ownership.

278. The two ski fields, together with Ruapehu District Council, conducted a joint marketing campaign in Australia over the period 1993-95. That experience suggests that separate owners have in the past been able to market Mt Ruapehu cooperatively as a skiing destination, and to attract overseas visitors. It therefore raises the question as to whether a similar campaign could be introduced in the future by two independent ski field operators in the counterfactual scenario.

279. Table 6 sets out what was achieved by the 1993-95 campaign. These figures are based in part upon information provided by Mr Alan Williams ("Mr Williams"), the owner of one of Australia's largest travel wholesalers (SkiONE), who was instrumental in organising the campaign. According to him, the campaign attracted approximately 600 visitors to Mt Ruapehu in 1993, with an average stay of 8-9 nights. In the following year, the number of visitors increased to just under 1,000. In 1995, bookings had increased by 24% when the eruption intervened.

TABLE 6
Results of Joint International Marketing Campaign, 1993-95
(actual and projected)

	1993	**1994**	**1995***
Visitor numbers	600	1,000	1,240
Skier-days **	4,800	8,000	9,920

* Based on 24% increase on 1994.
** Assuming an average of 8 days per visitor.

280. The numbers of visitor and of associated skier-days in Table 6 provide a basis for estimating the sorts of numbers that could potentially result in the counterfactual from a joint international marketing campaign run over a five year period. Although projections of what might have happened had the campaign persisted in 1996 and 1997 are hazardous to make, one approach is to assume that the average annual growth trend over 1993-95 would have continued. On that basis, skier numbers would have increased to about 1,780 in 1996 and to about 2,500 in 1997, with skier-days increasing to about 14,240 and 20,000 respectively.

281. One important issue is why the campaign came to a premature end in 1995. According to RAL, a number of factors contributed to the collapse. Apart from the volcanic eruption of Mt Ruapehu in 1995, which was an important factor, it was argued that the two partners did not share the same level of commitment. For example, RAL wanted both parties to contribute $50,000 each year, but TSR would commit only to $20,000, and so the latter figure was the one agreed. Similarly, TSR would commit only to one year at a time, whereas RAL was keen to commit to a longer period. The two parties also had difficulty agreeing on the formula used to split the revenue generated by the joint pass. Others mentioned that the imbalance in the sizes of the two parties might create difficulties. RAL submitted that similar difficulties are likely to emerge under any attempt to reintroduce a similar campaign by separate owners in the future.

282. It has proved to be difficult in retrospect to determine the weights to be attached to the various contributing factors. According to Mr Williams, the eruptions were the major reason behind the termination of the campaign. Mr Bruce Rollinson, District Marketing Manager for the Ruapehu District Council, suggested that an important factor undermining the campaign was an uneven level of commitment by, and internal tensions between, the two ski fields.

283. A number of submissions which commented on the benefits potentially available from marketing Mt Ruapehu as a single destination appeared to accept that a cooperative approach between separate ski fields may attract some additional international skiers. However, most submissions believed that a single owner would be more effective. For example, Mr Williams stated:

> "I have no doubts that Mt Ruapehu would attract more skiers if it were marketed as a single destination. I don't believe that two separate owners can do this as effectively."

284. He went on to refer to the difficulties that he had experienced in dealing with the two ski fields during the joint campaign over 1993-95.

285. Mr Rollinson informed the Commission that he had attended several promotions held in Australia as part of the 1993-1995 joint marketing campaign. He witnessed that:

> ". . . even at that lower level, the rivalry between the staff was quite noticeable and sometimes not in the best interests of marketing the region as a whole. The staff would promote their own field, not the mountain or destination as a whole. The promotion of the mountain was, therefore, not a whole-hearted effort . . .
>
> . . . if the two Mt Ruapehu fields tried joint marketing again, the same situation as that described above would arise and this would cause customer doubt and dissatisfaction. I strongly believe the Australian travel wholesalers who packaged Mt Ruapehu skiing during this time would look at any future attempts to joint market Mt Ruapehu rather cynically due to their experiences in dealing with two separate companies with different marketing commitments. Why would they wish to deal with two separate North Island companies when they have the simple choice of sending customers through the one South Island

> company, Mount Cook, who own and operate three ski areas? . . . I am certain the problems [of joint marketing] could be alleviated by joint ownership."

286. NZIER emphasised that there are likely to be inherent uncertainties in a joint marketing campaign run by two independent and competing ski field operators compared to a campaign under single ownership. In its submission, it stated that:

> ". . . in advising on RAL's Application, we emphasised the requirement that benefits claimed could not include cost savings or output gains which might occur due to cooperation between the two ski fields under separate ownership . . . We think the Commission has overestimated the likelihood and extent to which competing owners of Whakapapa and Turoa would, and could, actually cooperate."

287. The NZIER went on to argue that there would be considerable difficulties in identifying, and therefore allocating, the returns from any cooperative marketing by the two ski fields under separate ownership. This and other transaction costs would be "likely to lead to a lower than optimal investments in such activities." Similarly, Mr Cooper noted at the Conference that any joint marketing campaign will tend to be restricted by the party with the lower level of commitment. For example, if one party were prepared to invest $50,000, but the other were willing to commit only $20,000, the likely end result is collective funding of $40,000. This is likely to represent an under-investment compared to the funding that a single owner, who would receive all of the benefits, would be prepared to commit to.

288. Mr Davidson stated at the Conference that over the previous 13 years he had been involved in quite a number of joint-marketing-type initiatives, and that his involvement had probably been more with proposals than with actually running the initiatives. There was more cooperation mooted than actually undertaken. He stated that to get a joint marketing programme off the ground was difficult, even with the initial goodwill of the parties concerned, because they have to agree on what target market they are actually targeting (which is not always achievable), work out equitable financial contributions, and focus on expanding the market rather than on fighting over market share.

289. According to submissions received, a successful international marketing campaign will require a medium- to long-term perspective, and, where it involves several parties, a high degree of trust. Any joint campaign will be subject to a degree of commercial conflict and uncertainty. In particular, each party will be trying to maximise its return from a given level of investment in the campaign; it is reasonable to expect each field to try and capture as much of the benefit as possible. To the extent that such tensions can be managed within the context of any joint arrangement, the campaign is likely to be more effective. Although the 1993-95 campaign appears to have been reasonably successful, as suggested by the figures in Table 6, the implication of such comments is that greater results could have been achieved if the effort had been based on a stable and long-term commitment under single ownership.

290. Further light on the issue is shed by the experiences of international marketing by the ski fields in the South Island. The Commission was told that in the mid-1980s, 80% of Australians who visited the South Island to ski went to Mt Hutt, and only 20% went to Queenstown. In response, local Queenstown leisure interests, including the owner of The Remarkables and Coronet Peak ski fields (nzski.com, owned ultimately by Air New Zealand), jointly funded an aggressive marketing campaign in the Australian market in conjunction with travel agents. By 1995, the campaign had succeeded in reversing the earlier shares between the Mt Hutt and Queenstown ski fields. This shows the potential for success of a broadly based marketing campaign.

291. Mr Cooper noted in his submission that the Queenstown marketing campaign initially involved only the Air New Zealand owned ski fields at Queenstown, along with a number of hotels. He said that the Queenstown fields actively sought to exclude Cardrona from the marketing group, and succeeded in doing so until recently. Cardrona ski field was only invited to join the marketing group in 2000 as a result of pressure from the hotel interests within the group. However, it is too early to assess whether this development has been successful, although it is understood that nzski.com has threatened to withdraw from the Queenstown campaign. This appears to lend support to the submissions that competing ski fields find it difficult to cooperate over marketing.

292. Similarly, in an interview with Commission staff, Mr Gilbertson of Cardrona expressed his belief that a joint marketing venture with Treble Cone is possible, although there are potential difficulties as a result of the two companies each having a different focus. These tensions could be avoided by a campaign run by a single operator of the two fields.

293. An alternative view is that tourism companies do have incentives to collaborate in promotions, partly because in the New Zealand setting many are too small to be able to fund their own individual campaigns, and partly because in being specialised in particular functions (for example, accommodation, transport, skiing), much of the benefit from any individual promotional spending they might undertake would be captured by the other entities. This inability to capture all of the benefits from individual promotional activity could have two consequences: either little promotional spending would be undertaken (because the benefit each individually could capture would not generate sufficient profits); or the various entities would be encouraged to participate in a joint marketing campaign, despite the difficulties of so doing (where each would capture some of the spill-overs from the spending by the others). The Commission understands that in the very large ski resorts overseas, such as in the United States, joint marketing is routinely undertaken, although a feature of such resorts is that a significant proportion of the revenues are made outside of actual skiing, such as in real estate developments and the provision of accommodation services.

294. In conclusion, after considering all of the arguments put before it, the Commission has reached the view that international marketing of skiing on Mt Ruapehu would be possible under a campaign run jointly by the two fields under separate ownership. The fairly recent experience of a joint marketing campaign in Australia over the period 1993-1995 provides an indication of what might be achieved by such a campaign, were it to be run in the future. However, the Commission acknowledges that joint international campaigns are hindered by the presence of transaction costs associated with the separate parties needing to reach and maintain an agreement to cooperate, and by the ongoing uncertainties associated with incentives for each partner to engage in free-riding and other opportunistic behaviour at the expense of the other. Hence, the Commission is of the view that while international marketing would be likely under both the countefactual and single ownership, the latter is likely to have a greater degree of success than would otherwise be the case.

Conclusion on the Counterfactual

295. The Commission has reached the conclusion that in assessing detriments and benefits, it will 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.

296. It has also reached a view about the types of behaviour that can be expected under the counterfactual, compared to what is likely if the proposed acquisition were to proceed. These are summarised in Table 7.

TABLE 7
Comparison of the Counterfactual and Acquisition Scenarios

New Initiatives	Counterfactual	Acquisition
Seamless lift pass	Less likely	Likely
Traverse	Likely, but to a lesser extent because of the lesser likelihood of a seamless pass	Likely
International marketing	Likely, but to a lesser extent	Likely

DETRIMENTS

Introduction

297. 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, relative to the counterfactual scenario where the two ski fields on Mt Ruapehu would remain independently owned and would continue to compete. As noted above, the Commission uses an economic efficiency approach to the measurement of detriments. The assessment is carried out under the following headings used by the NZIER: allocative inefficiency, productive inefficiency, dynamic inefficiency and product quality.

298. As noted in the "Competition – Other Constraints" sub-section above, a number of arguments were put forward by the Applicant and others as to why the detriments were likely to be limited in this case. These included the constraints provided by the following features of the defined market for North Island skiing: the peripheral competition offered by alternative winter leisure activities; RAL's structure and the internal role of RAL's Constitution and of the Trust; the pressure from skiers' service expectations; the peripheral competition from the South Island ski fields; and the alleged inability of the combined entity to price discriminate. Apart from the last, which the Commission does not accept, the Commission is of the view, as indicated above, that these factors collectively would provide a limited constraint on the combined entity, but not one that would be sufficient to prevent the combined entity

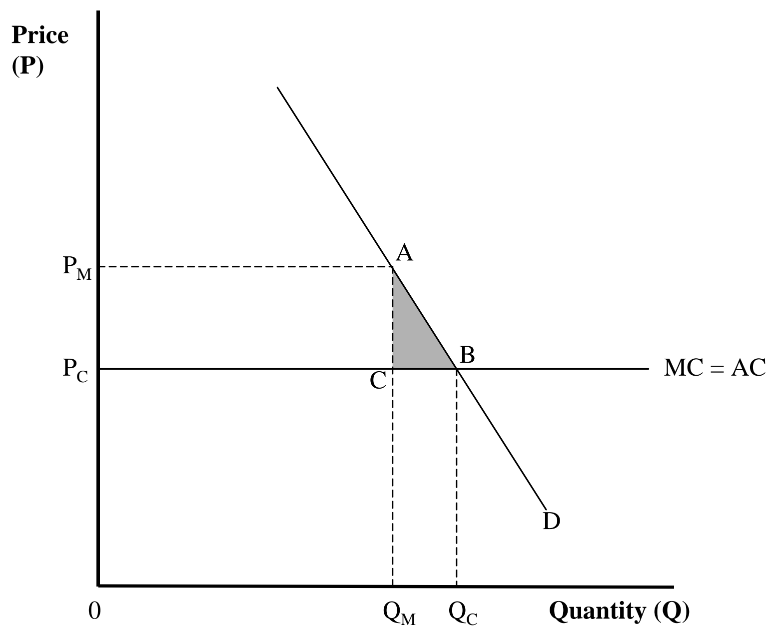
from becoming dominant in the relevant market. The effect of this limited constraint is built into the Commission's assessment of detriments below.

Allocative Inefficiency

Introduction

299. Subject to certain limited reservations, the economy's scarce 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 that 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).

FIGURE 1
A Model of Allocative Inefficiency in a Market



300. 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 would result from the loss of competition in the market implied by the sub-optimal output of Q_m.

301. In addition, the area P_cP_mAC in the Figure 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.

302. 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).

303. 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 Initial Claim

304. The NZIER claimed in its original submission that the combined entity would be unable profitably to raise prices above the competitive level. It believed 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 any price increase by the combined entity being unprofitable. However, even if a price rise were to eventuate, it considered that the deadweight loss from allocative inefficiency, as a matter of principle, would be likely to be small.

305. The Applicant also noted that under the terms of its DOC licence to operate a ski field on Mt Ruapehu, TSR had to submit any proposed price change to DOC for approval. It claimed that DOC's price supervision would act as a constraint on any attempts by the combined entity to raise prices at Turoa post-acquisition. However, DOC has told the Commission that it does not view itself as being a price regulator, and that it considers that such activity falls within the responsibility of other agencies. Sutton McCarthy also pointed out that Turoa had announced that it was to be closed before the official end of the season in the week following the Conference, and that DOC had not raised objections to that move, although skiers might. It was suggested that DOC was not offering much protection in that area, implying that its price monitoring role might similarly be muted.

306. Dr Stroombergen of Infometrics, economic expert for Sutton McCarthy, suggested that RAL's bid, as the winning bid, was likely to be at the high end of the range, and

that this could reflect its ability to repay the higher price out of prospective monopoly profits. This was disputed by Mr Mazey, who said that RAL had used conventional investment appraisal techniques to determine its bid price, and that the size of its bid reflected the expected income streams of the combined entity based on current prices, together with expected synergy gains.

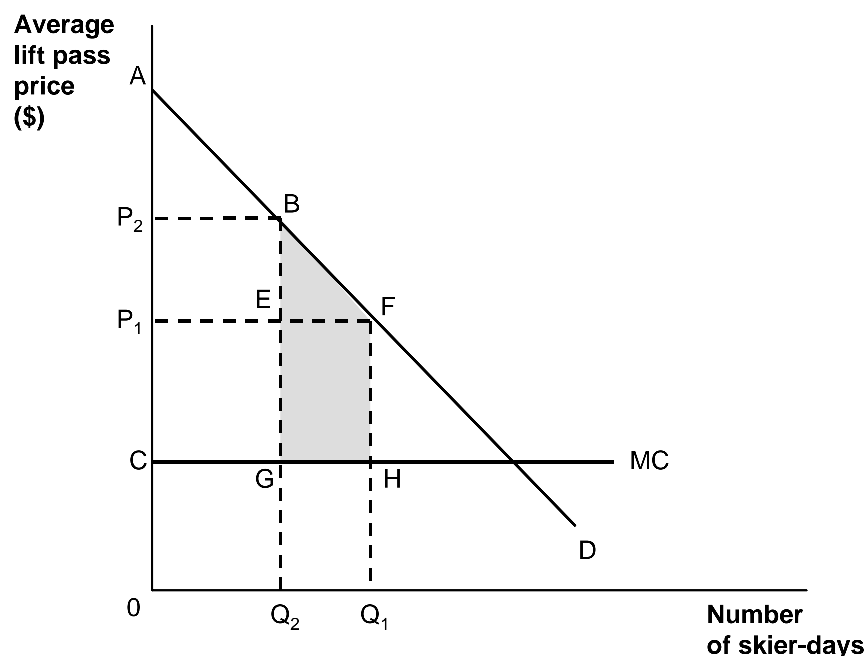
307. Mr Traveller also responded to this argument by noting that RAL's bid was similar to others, suggesting that a "market price" had been offered. However, as indicated above, RAL's bid was [

]. The Commission considers that these bid differentials could support either of Dr Stroombergen's "monopoly" argument and Mr Mazey's "efficiency" argument, or a combination of the two, or merely that they reflected the outcome in a 'thin' market for a risky business.

The Commission's View

308. The Commission made clear its view in the Draft Determination 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 effects examined generically in Figure 1. However, in order to calculate the magnitudes of those effects, the model had first to be adjusted to reflect the specific characteristics of the relevant market. This was done using Figure 2.

FIGURE 2
Estimating Allocative Inefficiency in the North Island Skiing Market



309. The vertical and horizontal axes of Figure 2 are scaled in terms of the average lift pass price and the number of skier-days respectively.[15] 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.[16]

310. The short-run (rather than the long-run) marginal cost curve is depicted in Figure 2. There are a number of reasons for this use of short-run analysis. 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. Finally, the short-run approach appeared to be consistent with the way that the NZIER calculated some of the claimed benefits.

311. However, the industry must cover all of its costs, including fixed and overhead costs, and so prior to the proposed acquisition the price is assumed to be 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.

312. 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. It was on this basis that the Commission made its preliminary estimates of allocative inefficiency losses in the Draft Determination.

The Applicant's Response

313. In its submission and at the Conference, the NZIER raised two issues about the Commission's approach to the calculation of allocative inefficiency in the Draft Determination: first, that the Commission's approach had changed from what it had been previously in other cases; and secondly, that it had not taken complementary sales into account. Both are now examined in turn.

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

[16] 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. However, at the Conference it was said that it was very rare for both fields to be operating simultaneously at full capacity, even at weekends.

Nature of the Model

314. The NZIER claimed that in using the model based on Figure 2, the Commission had departed from its usual approach to the calculation of allocative inefficiency, as set out in the Public Benefit Guidelines, which related to the use of the model framed in Figure 1. It argued that the "new model", which it alleged reflected a relaxation of the assumption of a competitive market prior to the acquisition (presumably because price was assumed to exceed marginal cost), had not previously been employed; that it rendered allocative inefficiency estimates more sensitive to parameter values, especially price elasticity of demand; and that it also introduced an additional parameter to be estimated, namely marginal cost.

315. However, the Commission, in previous cases, has always sought to modify the basic model in order to reflect the specific characteristics of the market in question. For example, in *PowerCo/Egmont Electricity* (Decision No. 302, 21 July 1997), the Commission assumed that the pre-merger price was 10% above the competitive level because of the presence of pre-merger market power. A consequence of that assumption was that any further post-merger increase in price would lead to a loss of producer surplus as well as of consumer surplus. In *Air New Zealand/Ansett Holdings* (Decision No. 278, 3 April 1996), in which the NZIER was the applicant's economic expert, a downward-sloping marginal cost curve was built into the model to reflect the presence of economies of scale in the airline industry. Further, this approach was clearly flagged in the Commission's Occasional Paper 7 on "The Evaluation of Public Benefit and Detriment Under the Commerce Act" (February 1998).

316. In the current case, the model used in the Draft Determination assumes that the pre-acquisition price is above marginal cost because the operation of a ski field involves substantial fixed costs, and these have to be covered by price even in a competitive market. The Commission notes that the Act defines "competition" as meaning "workable or effective competition", in contrast to the perfect competition model that the NZIER seems to have in mind.

317. As the NZIER noted, this model tends to raise the allocative efficiency losses associated with any price rise following the acquisition, as there is a reduction in producer surplus as well as consumer surplus. However, the same model is used by the Commission in valuing public benefit, in the form of the claimed increase in skier-days, which similarly has the effect of increasing both consumer and producer surpluses. Hence, the nature of the model increases both detriments and benefits, relative to the one apparently preferred by the NZIER. The NZIER was invited at the Conference to consider whether the model might have a differential impact on detriments and benefits, and to make a submission on the matter to the Commission, but no such submission has been received from it.

318. Claims by the NZIER that the results of the "new model" are more sensitive to parameter changes than the "old model" appear to be without foundation. The argument against the "new model" that it introduces the possibility of new estimation errors, because of its requirement to calculate marginal cost, does not seem to carry much weight when it is balanced against the fact that the use of an inappropriate model is likely to generate greater error.

<u>Complementary Sales</u>

319. The NZIER and others have pointed out that the pricing of lift passes by ski field operators would rationally take into account the implications for their sales of complementary products, such as equipment hire, creche services, and food and beverages. Mr Mazey reported at the Conference that RAL's non-skiing pass revenues accounted for about 45% of the total. He argued that an increase in lift pass prices would reduce not only the numbers of skier-days, but also the net revenues from complementary goods sold to each of those skier-days. This would limit the incentive for the combined entity to raise lift pass prices.

320. The complementary sales of ski field operators is an example of "interdependent demand" within the business firm.[17] Firms typically produce a range of products that are often related in demand, either through being substitutes or complements. Where the demands for the firm's products are interdependent, the pricing of each product has to take into account the potential impact on the sales of the others. As a general rule, a firm wishing to maximise profits would raise a product's price when it produces other products that are substitutes for it, and lower a product's price when it produces other products that are complements to it, relative to the price that would maximise profits for that product if its demand were not interdependent with those of others.

321. In the present case, demand interdependency might be modelled on the assumption that the marginal returns from complementary sales is a constant figure determined by the average net revenue per skier-day.[18] This simplification means that Figure 2 can then be adjusted by adding that dollar figure to the demand for lift passes, causing it to shift upward vertically by that amount to become the 'interdependent' demand curve (the associated marginal revenue curve will also shift upwards by the same vertical distance). As before, competition between the two ski fields results in price being set at the point of intersection between demand and average cost, but as the average cost curve is downward sloping, the intersection point with that higher interdependent demand curve will be found at a higher quantity and lower combined 'price' for lift pass and marginal return from complementary sales. At that point, the price for the lift pass alone would be lower again. In other words, competition might be expected to lower the lift pass price below its average cost in order to attract more skier-days, with the resulting losses on the skiing side of the business being met out of the additional surpluses generated from the sales of complementary products. This outcome is consistent with the view that complementarity lowers price.

322. On the basis of this analysis, complementary sales could be accommodated in Figure 2 by assuming that the demand curve illustrated remains that for lift passes, and that the Q_1 skier-days is determined by the intersection of the higher interdependent demand curve with the average cost curve (neither of which are illustrated). Once that quantity is known, the resulting competitive lift pass price can be read off the D curve as being P_1.

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[17] See, for example, William F. Samuelson and Stephen G. Marks, *Managerial Economics*, (2nd edition), Fort Worth: Dryden Press, 1995, pp. 105-08.

[18] This is tantamount to assuming, amongst other things, that the prices charged for complementary products do not influence the demand for lift passes. In any case, competition in those markets should ensure that even the combined entity would not be able to raise the prices of such products.

323. However, although the presence of complementary sales serves to lower the lift pass price under competition, relative to what it would be without such sales, it does not follow that the combined entity would have no incentive to raise price post-acquisition. The equilibrium competitive price as defined is likely (depending upon the value of price elasticity of demand) to be at an output larger than the profit-maximising one, in which case the combined entity would have an incentive to raise price in order to increase profits after the acquisition. The combined entity might seek to maximise profit by equating marginal cost with marginal revenue, where the marginal revenue curve is that associated with the interdependent demand curve. This would lead to a rise in the lift pass price. Hence, the increase in price from P_1 to P_2 depicted in Figure 2 would still be likely, even with complementarity in sales.

324. In summary, recognition of the demand interdependency does not appear materially to change the analysis, or the quantification, of the allocative inefficiency effects using Figure 2, with one qualification. That concerns the level of the profit-maximising (or monopoly) price. That price could be higher with the interdependent demand curve than that with the non-interdependent demand curve, under the assumptions specified. However, it has to be recognised that under other assumptions, that price could be lower. The critical point remains that the combined entity would still be likely to be able to increase its profits by raising its price post-acquisition.

325. On this basis, and given that the Commission has not had the opportunity to put this revised model before the various parties for comment, it has resolved to continue to base its analysis of allocative efficiency on the model set out in Figure 2.

Calibration of the Model

326. 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 discussed in the following sub-sections.

<u>Price and Quantity</u>

327. A difficulty with estimating price and quantity in this case, and indeed the features of the demand curve generally, arises from the impact of the poor snow years and of the volcanic eruptions in the mid-1990s. It seems that many North Island skiers developed a taste for other winter leisure activities during this period, or travelled further afield to ski in the South Island. In economic terms, the demand curve in the North Island skiing market shifted leftward, indicating a reduced demand at any price. This reduction in demand was more than would be expected in a poor snow year; the succession of poor years meant that regular skiers might have been turned away from the sport altogether, and others might not have taken up the sport who would otherwise have done so. In addition, there appears to have been a secular trend, also evident overseas, toward fewer days skied on average per person per year, which led to a view recently that the season pass was over-priced.

328. The Commission was told that these factors lay behind the decision to offer a season lift pass for the 2000 season in April 2000 (prior to the start of the season) at the drastically reduced price of $199. It was felt that people needed to be encouraged to get back to skiing after the bad years, and to be encouraged to ski more often. However, there was uncertainty about the commercial impact of such a drastic price reduction. While similar price cuts had apparently been successful in one or two ski

fields in the United States where it had been tried, price variations of this magnitude had not before been tested in this country, and so the nature of the demand response was unknown.

329. However, the Applicant claimed at the Conference that the reduced season lift pass price had been commercially successful, in that there has been a huge increase in the demand for season passes (which was offset to some degree by a decline in day pass sales), with both skier-days and revenues having increased. It is currently uncertain as to whether similar prices will be offered for season passes in the 2001 season. RAL has pledged to introduce a joint pass at $239 in 2001 should the acquisition proceed. While the focal point for market pricing has clearly changed dramatically recently, pricing patterns in the future remain uncertain. In the face of this uncertainty, the Commission has chosen to assume, in framing the counterfactual scenario, that the new level of pricing will persist into the future.[19]

330. The Applicant has calculated that the weighted average price of a lift pass on Mt Ruapehu in the 2000 season is expected to be $[ ]. 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. It has to be noted that 'price' in this instance is a somewhat vague concept as, for example, season pass holders have the power to determine the 'price' they effectively pay through the number of days they choose to ski during the season.

331. As indicated earlier, 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.

332. Consequently, for the purposes of this exercise, the Commission takes the current price, and also the price in the counterfactual, as being $[ ], and quantity as being 425,000 skier-days. The product of these two figures indicates that the combined entity is projected by the Applicant to yield revenues from "ski field operations" (apart from ski school) 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.

<u>Price Elasticity of Demand for Skiing Trips</u>

333. In its Draft Determination, the Commission noted that 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 seemed likely that demand would be in the elastic range, i.e., exceeding one in absolute terms. On this basis, it was assumed for the purposes of calibrating the model that the likely value would be found in the range between –1.0 and –2.0.

334. As noted above, the Applicant stated at the Conference that the lowering of the season pass price for passes sold pre-season to $199 had led to a very large increase in the number of such passes sold (from about 1,000 to over 17,000) and to an increase in

[19] Sutton McCarthy suggested that the low season lift pass price, when offered prior to the start of the season—and assuming it was non-refundable—could be seen as a kind of insurance for the ski field operator against a poor ski year. Skiers were benefiting from the low price, but at the same time carried the risk that adverse conditions might lead to a curtailment of their skiing opportunities.

revenues, and that the strategy had been commercially successful. This is consistent with the demand curve being price elastic in the relevant region, since a price reduction with a price elastic demand curve causes total revenues to increase. However, such information cannot be used to compute the price elasticity, in part because demand is made up of sales of day and other lift passes, which no doubt declined over the same period.

335. A further consideration, as discussed above in the competition section, is that while the market has been defined as the North Island skiing market, demand in that market may be influenced to some degree by the presence of other products and services which, while not considered to be close enough substitutes to fall in the same market, do offer peripheral competition. Other winter leisure pursuits—such as South Island skiing, other winter holiday destinations, and other winter sporting activities—are recognised as competing with North Island skiing to a limited degree. The presence of this peripheral competition would also suggest that demand in the relevant market is likely to be price elastic.

336. At the Conference the NZIER said that it had conducted a search to find estimates of skiing demand curve elasticities in other studies, but had been unsuccessful. As a result, it had decided with the Applicant to commission a survey of skiers "September 2000 survey" to elicit the information needed to calculate those elasticities.

337. The limitations of the September 2000 survey was discussed earlier. With respect to responsiveness to pricing, the respondents were asked (Q15) if lift pass prices on Mt Ruapehu had been 10% higher, would they have still come skiing on this trip. Those who answered "No" or "Don't know" were asked no further questions on pricing. Those who answered "Yes" were asked two further questions: (Q16) would the total number of days you spend skiing at Mt Ruapehu during the season decrease? And (Q17) how many days less would you ski?

338. Faced with the hypothetical 10% increase in lift pass prices, 19% (77) said they would not have come on the trip, 7% "didn't know", and 74% would still have come. Of the 74% who would have come, 31% (i.e., 23% of the total sample, or 92) said they would ski 3.3 days fewer days on average this season (and 3% didn't know how they would react). Thus, overall, 19% would not ski, 23% would ski 3.3 days less per season on average; and 10% might ski less or not at all.

339. The NZIER used these responses to estimate the price elasticity of demand for skiing on Mt Ruapehu. The 10% price increase had to be matched against the percentage drop in skier-days in the sample. Given that the average number of days expected to be skied at Mt Ruapehu during the season by the respondents without the price increase averaged 11.3, the total days skied by the sample was calculated as being 398 $\times$ 11.3 = 4,497. The reduction in skier-days associated with the price increase was estimated as the sum of the days lost by those who would not ski (77 $\times$ 11.3), together with the days lost by those who would ski fewer days (92 $\times$ 3.3), making a total of 1,174. Hence, the drop in skier-days by the sample was 26.1%, giving an estimated elasticity for the sample—and by extrapolation for the entire population of skiers—of –2.6. If season pass holders were excluded from the sample, the estimate of price elasticity became –2.1. The latter estimate was favoured by the NZIER.

340. However, it is important to note that this elasticity is that for the demand for ski field lift *passes*, not for skiing *trips*. For reasons set out in the following sub-section, the NZIER estimate had to be doubled to produce its estimate for skiing trips. Hence, as

Mr Feil noted, the NZIER's estimate of the price elasticity of demand for skiing trips derived from the survey was –4.2.

341. Dr Yeabsley of the NZIER also produced at the Conference a range of 29 price elasticities estimated for various household goods and services drawn from an American textbook. These products were categorised into those with inelastic, approximately unitary and elastic demands, with the overall range falling between –0.1 and –4.6. He suggested that given the discretionary nature of spending on skiing, the estimated skiing trip price elasticity of –4.2, in falling at the upper end of the range given in the textbook, seemed reasonable. However, the Commission believes that that price elasticity is probably unusually high (in absolute terms) for a market demand curve. In the textbook listing, only three elasticities exceed 2.8—foreign travel (long-run), 4.0; Chevrolet automobiles, 4.0; and fresh tomatoes, 4.6—and even assuming that those figures are accurate, the latter two are for products that are unlikely to constitute a product market by themselves, and the first is for demand in the long-run, which may not be appropriate for the purposes of competition analysis.

342. As indicated earlier, the Commission has come to the conclusion that little weight can be placed upon the results of the survey. This conclusion extends to the price elasticity estimate produced using the data generated by the survey.[20]

343. In his submission, Dr Stroombergen criticised the use of the high price elasticity figure of –4.2 by the NZIER on grounds other than it had been derived from an unsatisfactory survey. He stated at the Conference that, in his view, the Commission's assumptions used to fix a range for the price elasticity were justifiable on *a priori* grounds, and was supported by his recent research on gaming demand curves in the New Zealand gaming industry. This research, which used sophisticated econometric techniques and the Almost Ideal Demand System, had found a price elasticity of demand for "all gaming combined" of only –1.14. His view was that since gaming involved discretionary expenditure like skiing, and the addictive behaviour of some gamblers was likely to be matched by similar behaviour by some skiers, the price elasticity of demand for skiing was likely to be similar to that estimated for gaming. He therefore considered that the price elasticity of demand for skiing trips was likely to be in the region of –1.0, and that the Commission's upper bound of –2.0 was likely to be too high.

344. Although Dr Stroombergen's research methodology was not discussed at the Conference, it was commented that one weakness in his approach was that the prices used for the different forms of gaming were implicit prices, based on gambler 'returns', which most gamblers would not have been aware of.

345. The Commission has considered all of these submissions. As indicated above, it believes that the survey results cannot be relied upon, although they are consistent with *a priori* expectations that skier demand is likely to be price elastic. The Commission also recognises that empirical research suggests that price elasticities for market (as opposed to more narrow product) demand curves tend to cluster around a value of –1.0, but that products characterised as being "luxuries" are usually more 'price sensitive', having price elasticities somewhat greater than one (in absolute

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[20] The Commission also notes that the NZIER recognised that with the estimated price elasticity of –2.1, along with the other parameters of the model discussed below, the lift pass price would be already *above* the profit-maximising level. This seems implausible given the competitive nature of the market, unless it could be argued that a lack of price experimentation on the part of the ski field operators had left them ignorant of the nature of the demand curve and of the profit-maximising price.

terms). Bearing these considerations in mind, and given the uncertainty in this case, the Commission has resolved to continue to use the range of elasticities specified in its Draft Determination of between –1.0 and –2.0. The unknown price elasticity of demand for skiing is expected to lie between those two bounds.

Adjustment for Price Elasticity of Ski Passes

346. The price elasticity of demand just quoted is that 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, and each consumed in fixed proportions. 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.

347. As discussed earlier, the Commission has estimated the costs of skiing trips per person, involving three and seven day 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 equipment, travelling alone, or those with season passes; and higher for those with shorter travelling distances, or with access to private accommodation.

348. 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.

Marginal Cost

349. 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 allowed the Commission to estimate the marginal cost per skier-day as being $[ ].

350. In its submission and at the Conference the NZIER claimed that it had found further elements of RAL's costs that were likely to vary with the number of skier-days, and as a consequence had estimated marginal cost as being about $5.00. However, as it has not made any detailed presentation on how this figure was arrived at, the Commission is not inclined to place much weight on it. In any case, the estimates of allocative inefficiency are not particularly sensitive to which of the two figures is used. Hence, a marginal cost of $[ ] is used here.

Quantification of Allocative Inefficiency

351. The discussion in the last several paragraphs on the calibration of the model in Figure 2 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 lift passes in the range from –0.5 to –1.0; and
- constant marginal cost of $[ ] per skier-day.

352. 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 8.[21]

TABLE 8
Estimates of Annual Allocative Efficiency 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%.

353. The simulations in Table 8 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 would be an upper limit on the prospective price increase—that determined by the level of the monopoly price—of 7.2%. This might change slightly if the impact of complementary sales were to be added. 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 price increase needed to reach the profit-maximising level would be very much larger.

[21] The formula for calculating the dead-weight welfare loss (W) triangle BFE is: $W = 0.5 \times \Delta P \times \Delta Q \times M$, 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: $\Delta Q = \Delta P \times \varepsilon$, 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.

354. 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.

355. In addition, the model does not make allowance for the provision of ski school activities, which the Applicant has acknowledged is the 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. The Commission has not conducted a separate market analysis of ski school activities, and indeed, in response to a question on the subject in the Draft Determination, RAL said that it did not think that ski school activities should be defined as a separate market. Hence, the potential for allocative inefficiency to arise in that area has to be built into the estimates in Table 8. This has been done in Table 9 by scaling up the Table 8 estimates by [ ]%.

TABLE 9
Estimates of Annual Allocative Efficiency Losses and Wealth Transfers, Including Ski School Activities (Rounded)

Hypothetical Price Increase	Price Elasticity = -1.0		Price Elasticity = -0.5	
	Allocative Efficiency Loss	Wealth Transfer	Allocative Efficiency Loss	Wealth Transfer
1%	$101,000	$117,000	$51,000	$118,000
5%	$518,000	$559,000	$259,000	$574,000
10%	N/A	N/A	$533,000	$1,118,000
20%	N/A	N/A	$1,124,000	$2,119,000

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

356. In its submission in response to the Draft Determination, the NZIER produced the same estimates as in Table 8, but added additional estimates based on two factors: the alternative price elasticity of demand of –2.1 calculated using data from the September 2000 survey; and the alternative estimate of marginal cost of $[ ]. The latter resulted in relatively small changes to the estimates based on a marginal cost of $[ ]. With the elasticity of –2.1, prices would not be increased because the current (competitive) price would already exceed the profit-maximising level, and so no allocative inefficiency would be attributed to the proposed acquisition. While the NZIER thought that this was unrealistic, it considered that any price increase would be likely to be small. An increase of 3% was considered to be the maximum, and even with a price elasticity of –1.0, this would involve an allocative inefficiency loss of less than $280,000.

Conclusion on Allocative Inefficiency

357. 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 this particular case, further uncertainties were created by the following several factors: the lack of an accurate estimate for price elasticity of demand; the fact that the use of an average price might conceal the impact of possible future price rebalancing; the possibility that prices might change in the counterfactual; and the complications introduced by the presence of complementary sales. In the light of the above discussion, and after considering all of the information collected, the Commission concludes that the loss of allocative inefficiency in the relevant market would be likely to be in the range between $100,000 and $1,000,000. This relatively wide range reflects the various uncertainties mentioned, particularly the price elasticity of demand.

Productive Inefficiency

Introduction

358. A producer who 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

359. In its first submission the NZIER considered 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. It also argued 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.

360. At the Conference the NZIER contended that the scope for productive inefficiency on the part of the combined entity would be limited by the following factors:

- significant parts of the combined entity's business would continue to operate in competitive markets, with few inputs relating only to ski field services; and
- the business would continue to be run under different profit centres for different activities, with managers being held responsible for each, which would aid transparency and accountability, with inter-field comparisons being used for assessing managerial efficiency.

361. Dr Yeabsley also argued that evidence of improvements arising where former monopolies were exposed to competition may not accurately reflect what would happen if a merger were to extinguish a situation of competition, because the organisational framework set up in the competitive environment would tend to persist,

especially given monitoring by shareholders and directors. He also contended that a ski field operation was a "customer-hungry business" because of the relatively short season, and the high ratio of fixed to variable costs, and that this provided a strong incentive for the business to maintain efficiency. He also stated that it would be difficult for a company to go back from a position of efficiency because it could continue to benchmark itself against that efficient position.

362. Given these views, the NZIER considered that the Commission's estimates of productive inefficiency in the Draft Determination were over-stated. There, the Commission considered that the lines of business that 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 $[ ]. It was considered that all other revenue categories would continue to face competition post-acquisition. The combined base year cash costs (i.e., excluding capital-related costs such as depreciation) were 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.

363. Subsequently, the NZIER slightly revised its estimates of the costs that might be prone to increase as a result of productive inefficiency to a figure of about $8.5 million. It restated its position that its original estimates of the loss of productive efficiency provided in the Application were appropriate, which was 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 was argued likely only at the lower end of a range from 0% to 3% of the relevant costs, or between $0 and $254,000 per annum.

The Commission's View

364. As indicated above, the Commission's view is that the combined entity would acquire a dominant position in the North Island skiing market as a result of the proposed acquisition, and that that position would not be constrained either by South Island ski fields or by alternative winter leisure activities to any appreciable extent. Hence, it believes that the potential loss of productive efficiency would be 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, RAL's unusual corporate structure, its Constitution, with its objective of promoting skiing and its partial Trust ownership, might conceivably act as a limited constraint on the development of productive inefficiency.

365. 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.

366. 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."[22]

367. As indicated, the NZIER argued that such estimates typically are derived from the efficiency gains flowing from situations where monopolies are de-regulated, and that similar losses cannot be expected when the reverse process occurs. 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.

368. 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.

369. The Commission accepts the NZIER's estimates of the proportion of the combined entity's costs that are susceptible to potential inefficiency. For the purposes of illustration in the present case, and given the cost base, a 1% decrease in productive efficiency in the combined entity, as reflected by a 1% increase in costs, would give rise to a detriment of about $[ ] per annum, and costs would increase by the same magnitude for each further percentage point decrease, or proportion thereof.[23] 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

370. After consideration of the above factors, and on the basis of the information received, the Commission has reached the view that productive efficiency losses are likely to be in the range from [ ]% to [ ]% of the relevant costs of the combined entity's, or roughly between $170,000 and $680,000 per annum.

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

[23] 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.

Dynamic Inefficiency

Introduction

371. Dynamic efficiency is concerned with the speed at which an industry both 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) by 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.

372. 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. On the other hand, in a mature market where technological advance is typically slower, and demand may be static or even declining, the impact on dynamic efficiency from the emergence of market power is likely to be much lower.

The Applicant's Claims

373. Mr Mazey put forward the view at the Conference that RAL had a history of leading improvements in facilities on Mt Ruapehu, and that these were driven by the expectations of customers, as revealed by consumer surveys. RAL had never been forced into doing things because of competition from Turoa; rather TSR had tended to follow its initiatives. He cited as an example the fact that RAL was the first ski field in the country to introduce a detachable (or high speed) lift in 1986/87. These lifts, being faster, offer a better service to skiers and also have operating advantages. He said that that investment was not driven by competition from Turoa, and indeed, TSR had yet to follow suit. Similarly, RAL in 1989 was the first to introduce snowmaking on to Mt Ruapehu when advances in the overseas technology made its use practical on that mountain. Again, that investment was not spurred by TSR's presence as a competitor, which had only very recently introduced snowmakers on its field.

374. Mr Traveller spoke in favour of the Applicant's case. He argued that innovation is driven by the expectations of skiing customers, particularly those who ski internationally. Lack of scale at each of the Mt Ruapehu fields makes innovations involving major investments not economic (especially at the smaller Turoa). At least one large overseas skiing operator was not interested in bidding for Turoa because it was far too small. He believed that single ownership would therefore stimulate innovation. Similarly, Mr Cooper contended that innovation would be more likely under single ownership because of the greater combined revenue base, and the ability to manage the complementary development of the two fields (reducing the risk attached to the development of specialist facilities). Ski area developments are very

capital intensive, and there is the additional risk factor from adverse weather and snow conditions on Mt Ruapehu to contend with. He said that an assurance of profitability is needed to encourage investment.

375. The NZIER argued 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 claimed 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 claimed that rather than reduce innovation, the proposed acquisition would be likely to speed innovation, as the greater scale of the combined entity would allow greater, or swifter, investment in the capital-intensive facilities such as lifts and snow groomers needed for ski field operation. Moreover, innovation could be inhibited in the counterfactual, given the lack of marketing options available to the separate entities compared to the combined entity. It also contended that RAL would be able to benchmark itself against other ski fields, so that any failure to keep up with improvements at other fields would quickly become apparent.

376. Overall, the NZIER considered that the levels of innovation in the ski industry are low, and are driven largely by overseas trends and developments. As a result, the scope for dynamic efficiency losses would be limited mainly to those arising from delays, either in the adoption of new technologies or in the introduction of new services. The more price elastic demand curve calculated from the survey data would also serve to reduce the size of any losses stemming from a decline in dynamic efficiency (see below). The NZIER therefore contended that the potential loss of dynamic efficiency would be unlikely to exceed $150,000, and could approach, or actually be, zero.

The Commission's View

377. The Commission agrees that the technological innovation relating to the ski industry comes primarily 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 first used snowmakers in the 2000 season, whereas RAL introduced them at Whakapapa in 1989.

378. On-field innovation comes through the services provided by ski field operators, although these are not so much innovations as adoptions or adaptations of known techniques. Examples potentially 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; the use of up-to-date avalanche precautions; the introduction of high-speed chair lifts; and the use of various techniques for "managing snow", such as snow making, mining and grooming.

379. 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 generally 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 in order to attract more custom when skiing conditions are limited. Seamless lift passes can be introduced, which skiers can use at different fields, or arrangements can be made with other fields whereby season passes for one can be used at the others.

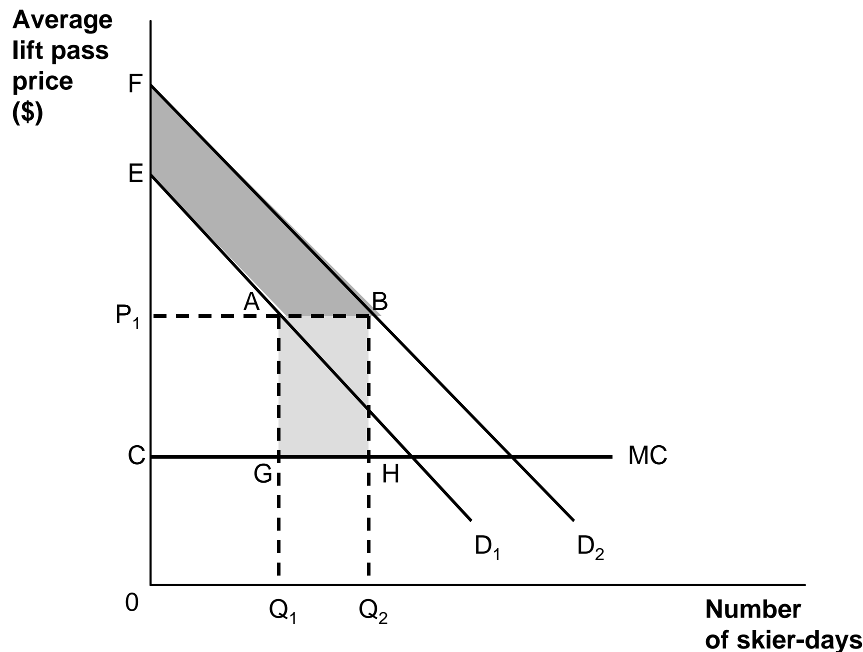
380. Marketing may focus on attracting particular age groups, or groups from particular origins, and may involve joint marketing with other fields or other tourism operators. The running of ski field competitions may also generate interest in the sport. Because there is a surplus of airline capacity 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, riding on the chairlifts, experiencing alpine conditions, undertaking guided trips to the crater lake, and visiting the shop and café. RAL began its summer programme in 1987, much earlier than at Turoa.

381. The skiing industry as a whole could perhaps be characterised as exhibiting a low to 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 substantial sums on investments in extending and improving facilities from time to time. This balance reflects the preceding discussion. Innovation in ski field operation is most likely in products, pricing and marketing.

382. The Commission does not accept the NZIER's argument that the scope for dynamic efficiency in the skiing industry is relatively low. The levels of expenditure on marketing, and the range of initiatives canvassed in RAL's 2000/2001 Marketing Plan suggests that this is not the case. Moreover, Sutton McCarthy suggest that there are a whole range of issues in which innovation could be pursued, such as the following: managing of capacity constraints; intra-week demand variations; new capital development financing structures; targeting marketing; sports competitions; and weather risk-sharing.

383. To gain some idea of the potential losses of dynamic efficiency that would follow from a decline in product innovation resulting from the acquisition of dominance in the relevant market by the combined entity, and of the factors that may influence its magnitude, the simplified economic model in Figure 3 was used. This shows the stylised demand and cost conditions in the market, essentially those facing the two Mt Ruapehu ski fields, as they are virtually the only producers in the North Island skiing market. It is assumed that the products in the market are susceptible to differentiation to some degree, and could therefore be differentiated further by innovation that would enhance market demand.

FIGURE 3
A Model of Potential Dynamic Efficiency Gains and Losses



384. 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 potential for the post-acquisition price increases considered above). 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.[24]

385. The size of the lost surplus in the model depends upon the following 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, were employed again here, as was 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 foregone is either 0.5%, 1%, or 1.5% annually. On the basis of these assumptions, Table 10 shows the corresponding estimates of potential losses from reduced product innovation.

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[24] 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. In Figure 3 it is assumed for simplicity that dominance eliminates product innovation, whereas it could have the effect only of reducing it.

TABLE 10
Estimates of Potential Annual Loss 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

386. When interpreting these estimates, it should be borne in mind that the model calculates the maximum of the range of possible losses, for any given assumptions as to price elasticity of demand and demand increase foregone. This is because it is assumed that those who would have skied the additional skier-days in the region between Q_1 and Q_2 would have transferred from other activities outside of skiing in which they would have been only marginal participants with consumers' surplus of zero. If some sacrifice of consumers' surplus would have been involved in transferring to skiing, and would therefore be regained if that transfer did not take place, that benefit would have to be netted off from the shaded area in Figure 3. However, the geometry of the situation indicates that the amount to be netted off would be relatively small.

Conclusion on Dynamic Efficiency

387. 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 9 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.

388. As indicated earlier, the Commission is of the view that there are a number of lesser constraints that might serve jointly to limit to some degree the potential loss of dynamic efficiency of the combined entity. These factors include RAL's Constitution, the presence of the Trust, its corporate structure, and the availability of the South Island ski fields and of alternative winter leisure activities.

389. In the light of the preceding discussion and analysis, the Commission is of the view that the potential loss of dynamic efficiency arising from the proposed acquisition is likely to be relatively small. The Commission's best estimate is that dynamic inefficiency could fall somewhere in the range between $100,000 and $350,000 per annum.

Product Quality

Introduction

390. It is believed that product quality may suffer under monopoly, when the sole firm's market is assured and buyers have no other suppliers to whom 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.

391. 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 (and assumed counterfactual) levels if the proposed acquisition were to proceed, all else remaining the same. This would be expected to be reflected in a leftward shift of the demand curve relative to the counterfactual, all else remaining the same, as consumers choose to buy less of the less attractive product. The impact of this could be measured in principle as the loss in consumer and producer surpluses, using welfare analysis similar to that employed for assessing dynamic inefficiency.

The Applicant's Claim

392. 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 variously 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.

393. At the Conference the NZIER argued that as a matter of principle, a company enjoying sufficient market power to set a monopoly price (for a product with a given level of quality) could not then improve its position by reducing the quality of the product, as the demand for the product would then fall, and with it the monopoly price. Hence, the detriment from the emergence of loss of product quality would be at least partially offset by a reduction in allocative inefficiency.[25] In short, the combined entity could not "double dip". Hence, there was a danger of double-counting the detriment associated with the price/product quality dimension of the firm's performance.

394. The NZIER also drew on further results of the September 2000 survey of skiers discussed above. The questions concerning a hypothetical 10% rise in lift pass prices were replicated for a hypothetical 10% reduction in "the quality of skiing facilities at Mt Ruapehu", with 10% meaning "a small but noticeable reduction in the quality of skiing facilities." From the responses, the NZIER estimated what appears to be a

[25] And possibly also in productive inefficiency, to the extent that that type of inefficiency is related to the larger wealth transfers generated by the higher price.

quality elasticity of demand of 2.8.[26] From this it was surmised that the combined entity would be likely to be constrained by the apparent high degree of sensitivity of skiers to product quality. It would rationally be more likely to change price than product quality, given the relative sizes of the elasticities revealed by the survey.[27]

395. As a result of these various considerations, the NZIER remained of the view that the amount of detriment from the loss of product quality would be zero.

The Commission's View

396. The Commission has already stated its view on the competition implications of the proposed acquisition. Hence, the erosion of product quality remains in principle a real possibility. While the Commission recognises the validity of the "double dipping" argument advanced by the NZIER, it did not assume in the Draft Determination that the combined entity would actually raise price to the monopoly level, thereby leaving scope for inefficiencies to arise simultaneously from losses of both allocative efficiency and product quality.

397. 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.

398. RAL has acknowledged to the Commission that the quality of the service at the time was very poor, and attributed it to two factors: the general approach towards service provision in the New Zealand economy at the time; and the fragmentation in the concession. With regard to the first point, it was suggested at the Conference that service levels must have been unusually poor, even by the standards of the time, if people still remember them thirty years later. 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.

399. With regard to the fragmentation in the concession, there were three different ski lift operators (including RAL) on the Whakapapa field. Hence, the poor service could not be attributed to a lack of competition, nor to market power held by RAL. In addition, the Tourist Hotel Corporation ("THC") ran ski field catering and ski hire, while the predecessor of DOC looked after the car parking, roads, toilets and ski patrol.

400. 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, although this was disputed by RAL

401. RAL argued at the Conference that experiences in the 1970s and 1980s give a misleading impression of performance. The presence of multiple concessionaires, and

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[26] The interpretation of this figure would then be that a 10% reduction in quality (however that might be subjectively perceived by skiers) would lead to a 28% reduction in skier-days. On this interpretation, the elasticity coefficient would have a positive sign, not the negative one given to it by the NZIER.

[27] If the results of the survey are taken uncritically, the price elasticity of demand including season pass holders was –2.6, which is not much different from the quality elasticity.

some regulatory restrictions on the scope of their operations, considerably hindered efficient operations. For example, the operator of the beginners' slopes could not operate a ski school or offer ski rental, which was the exclusive preserve of the THC, and this prevented the efficient bundling of service provision. Also, the separate operators could not agree on a funding arrangement to improve the access road. DOC was said to be concerned about its ability to manage the various concessions. In recognition of these problems, RAL at the end of the 1980s adopted a policy of acquiring the operations of others at Whakapapa when the opportunity arose. By this means, the various operations at the field were brought under the ownership of RAL.

402. Evidence on recent service quality is provided by the 1995 survey of Whakapapa skiers, following an earlier study in 1992. The later study found that while skiers perceived staff at Whakapapa as performing well, there were a number of areas where a relatively big gap emerged between what they 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 reflected 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.

403. 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. However, Mr Horrocks of the Ngauruhoe Ski Club, which has lodges at both Mt Ruapehu fields, said that the number of bed-nights per year was much higher at Whakapapa than at Turoa, a difference which his members attributed to the much superior facilities and quality of service at the former. He said that even if Turoa were to be acquired by RAL, it would take some time for its poor service quality culture to be turned around. Mr Sutton of Sutton McCarthy considered that such arguments were inconsistent with trends in the market shares of the two fields during the course of the 1990s, which appear to show an increasing share being gained by Turoa. He claimed that Turoa's market share had increased from 36% for the period 1988-94 to 41% for 1994-2000, although he was not able to provide annual figures.

404. Mr Cooper argued that it would not be possible "to turn back the clock" on service standards. This supported the view of RAL that service standards are driven by customer expectations, and that the trend was for increasing expectations to be placed on ski field operators. Mr Cooper also suggested that the revenues to be gained from sales of complementary products and services reduced any incentive to weaken service quality such that skiers would be diverted elsewhere. The Trust also sees its role as one of encouraging the Company to further its aims, and also those of the Trust, by formulating and implementing plans to advance the skiing facilities on Mt Ruapehu.

405. Mr Sutton noted that Simpson Grierson, counsel for the Applicant, had stated that under the proposed acquisition, the simple season pass would be withdrawn, and would be replaced by the proposed new joint pass covering both fields. He argued that this would disadvantage skiers who wanted to ski only on one field, and yet would be required to pay the higher price of the joint pass.

406. 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.

407. The potential sizes of the loss of product quality can be assessed using the model in Figure 3, if it can be assumed that a decline in product quality would be reflected in a drop in skier demand. In Figure 3, demand curve D_2 now represents the level of demand currently and in the counterfactual, and D_1 shows the position to which demand would shift if product quality were to drop. The loss of welfare resulting from the drop in product quality is then represented by the shaded area EFBHGA, which is similar to the analysis used to estimate dynamic inefficiency losses, and bears the same caveat with respect to marginal skier-days (those between Q_1 and Q_2).

408. The same parameter values as were used above to calibrate the model to calculate the loss of allocative efficiency are used again here. Illustrative demand shifts of –1%, -2% and –5% are employed. The resulting potential losses are given in Table 11.

TABLE 11
Estimates of Potential Annual Losses from Reduced Product Quality

Assumed Demand Decrease	Price Elasticity of Demand	
	-1.0	-0.5
-1.0%	$197,000	$304,000
-2.0%	$396,000	$610,000
-5.0%	$997,000	$1,541,000

409. A difficulty in using such estimates to predict the likely losses from reduced product quality is in first, implicitly assessing what decline in product quality is likely with the combined entity relative to the counterfactual, and then secondly, in converting that decline in quality into a drop in demand. With respect to the latter element, the NZIER used data from the September 2000 survey to produce an estimate of the quality elasticity of demand for lift passes of 2.8, as mentioned above. If this figure were to be accepted, it would suggest that in Table 11, the decreases in demand of 1.0, 2.0 and 5.0% would be triggered by drops in quality of 0.36, 0.71 and 1.8% respectively. However, as indicated, the Commission has resolved not to place any weight on the results of the survey for the reasons given earlier.

Conclusion on Loss of Product Quality

410. This detriment is difficult to measure, and care must be taken to avoid double-counting with other assessed detriments, particularly that stemming from the raising of price above the competitive level. The Commission recognises that because

product quality impacts on demand, the potential losses from allocative inefficiency and from reduced product quality are interrelated. For example, the combined entity would not be able to raise price to the profit-maximising level, and then lower product quality, without having to adjust price further. However, a firm that allowed product quality to slip might then, because of non-optimising behaviour with respect to pricing as well as product quality, no longer be maximising its profit.

411. The fact that under current competitive conditions, consumer surveys have revealed that service quality at RAL is not without blemishes, and submissions suggested that service quality is less good at Turoa, also have to be built into the counterfactual. The Commission also places some weight on the role of the Trust and the other indirect constraints to curb any potential losses of service quality on the part of the combined entity, although this has to be viewed in the context of an absence of competition. On the basis of these and the other considerations reviewed, the Commission concludes that the detriment from the loss of product quality is likely to fall within the range between $250,000 and $750,000.

Conclusion on Detriments

412. The Applicant, through NZIER, has argued that the scope for detriments caused by efficiency losses would be limited to small amounts of allocative, productive and dynamic inefficiencies, which in total would not exceed $684,000. This it regarded as an absolute maximum figure, with the actual figure thought likely to be much lower.

413. The Commission has reached the view, based on all of the information placed before it, and from its own analysis, that the potential detriments from allocative and productive inefficiencies and from the loss of product quality would be likely to be the most significant, and that the detriment from dynamic and inefficiency would be likely to be somewhat smaller. These estimates are summarised and aggregated in Table 12.

414. Overall, the Commission's view is that, as Table 12 indicates, the detriments from the proposed acquisition would be likely to fall in the range between about $620,000 and about $2,780,000 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.

TABLE 12
Summary of Estimates of Annual Detriments

Category	Range	
	Lower	Upper
Allocative inefficiency	$100,000	$1,000,000
Productive inefficiency	$170,000	$680,000
Dynamic inefficiency	$100,000	$350,000
Loss of product quality	$250,000	$750,000
TOTALS	$620,000	$2,780,000

415. The gaps between lower and upper bounds given in Table 12 are wide, reflecting in part the use of two different price elasticities of demand. With a view to assisting the balancing exercise at the end of this Determination, two different sets of ranges can be specified, one for each of the two price elasticities used. These are given in Table 13.

TABLE 13
Summary of Estimates of Annual Detriments for Each Price Elasticity of Demand (ε)

Category	Range (ε = -1.0)		Range (ε = -0.5)	
	Lower	Upper	Lower	Upper
Allocative inefficiency	$200,000	$700,000	$100,000	$1,000,000
Productive inefficiency	$170,000	$680,000	$170,000	$680,000
Dynamic inefficiency	$100,000	$230,000	$150,000	$350,000
Loss of product quality	$250,000	$450,000	$350,000	$750,000
TOTALS	$720,000	$2,060,000	$770,000	$2,780,000

416. These show that for the upper bound price elasticity of demand (-1.0), the aggregate of detriments are expected to fall in the range between $640,000 and $2,060,000. For the lower bound elasticity value (-0.5), the aggregate of detriments are expected to fall in the range between $670,000 and $2,780,000.

PUBLIC BENEFITS

Introduction

417. The Public Benefit Guidelines set out a number of important general principles in assessing public benefits. These include the following:

- the efficiency and other gains that constitute public benefits may include both tangible and intangible benefits;
- 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;
- benefits must be measured by reference to net gains, rather than by reference to changes in inputs or outputs on their own;
- benefits should not be double-counted;
- benefits (and detriments) should be measured against an appropriate counterfactual, a ‘with’ and ‘without’ comparison; and
- there must be a clear line of causality between the merger proceeding and the consequent benefits.

418. In relation to the current Application, it is important to emphasise the Commission's view that the benefits must be shown to result from the proposed acquisition. If the benefit 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.

419. This approach was agreed to by the High Court in *Fisher & Paykel* when it said:[28]

> "…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."

420. In addition, the court said in *Goodman Fielder/Wattie Industries* that the onus of proof is on the Applicant to show that public benefits outweigh the detriment caused by the acquisition.[29]

Claimed Public Benefits and Forecast Period

421. RAL claimed that there would be two main sources of public benefits flowing from the proposed acquisition. The first related to cost savings. RAL argued 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.

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

423. In submissions and at the Conference, most of the discussion on benefits focused on the claimed increase in the number of skier-days. In its submission, the Applicant reiterated its earlier estimates of the increase in skier-days claimed to flow from the proposed acquisition. However, the NZIER made a number of changes to its initial submission on the way in which additional skier-days were to be valued. These changes altered the claimed benefits arising from the proposed acquisition, and are discussed further below.

424. The final total benefits claimed by the Applicant are summarised in Table 14. The figures relate to annual benefits accruing by 2005. The Table shows that the claimed annual benefits arising from the proposed acquisition by 2005 are likely to fall within the range of $[ ].

[28] *Fisher & Paykel Ltd v CC* [1990] 2 NZLR 731, 741.
[29] *Goodman Fielder/Wattie Industries Ltd* (1987) 1 NZBLC (Commission) 104,108, 104,148.

TABLE 14
Claimed Annual Benefits for 2005

Category	Benefit
Operating cost savings	$[ ]
Increased output (net)	[ ]
Regional benefits	[ ]
Total	**[ ]**

425. In addition to the claimed savings in operating costs, the Applicant noted that further savings would be available through deferral of capital expenditure.

Cost Savings

426. The estimated cost savings related to one-off savings in capital expenditure and ongoing savings in operating expenditure. The claimed capital expenditure savings of $[ ] arose in the first year (2001) only, while the savings in operating expenditure recurred each year over the five year period.

Savings in Capital Expenditure

Redeployment of Capital Assets Across the Two Fields

427. In its Application, RAL claimed that the proposed acquisition would result in more efficient utilisation of the existing capital assets of each ski field. TSR currently owned two snow groomers and leased a further two, and this, according to RAL, had resulted in surplus grooming capacity at the Turoa ski field. The leases on the two snow groomers expire in July 2003.

428. RAL stated that Whakapapa required an additional groomer for the 2001 season. If the two fields were merged, RAL intended to introduce an additional shift at Turoa for grooming work, and this would release one of the groomers which would be transferred to Whakapapa. The Applicant claimed a one-off saving in capital expenditure in 2001 amounting to $[ ], although in RAL's subsequent submission, a saving of $[ ] was claimed.

429. In its submission, RAL agreed with the Commission's view that the claimed saving in capital outlays was based on a deferral of capital expenditure. However, RAL submitted that the deferred cost would be significant; the purchase by RAL of a new snow groomer could be pushed back two to three years. RAL suggested that another purchaser of Turoa could not utilise the excess groomer, although it recognised that the groomer could be sold by that party for approximately $[ ].

430. The Commission considers that no new information was provided after its Draft Determination to suggest that the claimed savings in capital expenditure was dependent 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 point was made by Mr

Keith Sutton at the Conference, who noted that any new buyer of Turoa who found there to be an excess asset would presumably dispose of it.

431. As a result, the Commission remains of the view that the claimed cost savings arising from the redeployment of snow grooming capacity may be available under the counterfactual, and has therefore placed no weight on the claimed cost saving.

Rationalisation of Maintenance Bases

432. Both of 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 claimed one-off gain of $[ ].

433. 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 to the base. Both RAL and TSR staff have noted that the main cost of this transportation involves the time taken to the load and unload the trucks, with that the distance travelled being a relatively minor element of cost. The Applicant has stated that the ongoing savings from running a single base, in terms of property insurance and rates for example, 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 was submitted to the Commission in support of this claim.

434. The submission by Sutton McCarthy indicated that the land value in respect of the RAL maintenance base at National Park was $27,000. Sutton McCarthy argue that the net proceeds from the sale of RAL's maintenance base would be unlikely to exceed $70,000.

435. It is difficult to predict the likely proceeds from the sale of such a property in what is likely to be a 'thin' market. However, in the absence of other information, the Commission believes that the Applicant's approach is reasonable. The claimed one-off saving of $[ ] is based on the Government Valuation of the capital and land value of one of the RAL properties in National Park.[30]

436. The Commission has decided to accept a figure of $140,000 arising from the disposal of a maintenance base under the proposed acquisition.

Event Management Equipment

437. 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.

438. 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 would be able to

[30] 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.

schedule events in a way which required the use of only one set. The timing gear is easily transportable from one field to the other.

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

Maintenance Equipment

440. The Applicant claimed 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."[31]

441. These savings appear to be possible through a rationalisation of inventories, such as of electrical and mechanical parts for ski lifts, for example. Currently, each ski field must tie-up capital in an inventory of specialist and expensive 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.

442. According to the Application, some of this claimed benefit related to a deferral of expenditure, and to the extent that it did, current savings would to some extent be offset by future purchases. This would 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.

443. No new information was provided to the Commission following its Draft Determination on the likely magnitude of these cost savings. As a result, the Commission has maintained its position of accepting a cost saving of $10,000 for 2001.

Savings in Operating Expenditure

i) Insurance

444. In the Application, RAL claimed 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 arose 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."[32]

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

446. As part of its submission, Sutton McCarthy included a facsimile from Gary Dome (Crombie Lockwood insurance brokers) that noted that he had discussed insurance premium savings with Paul McKay, and that they both eventually agreed that "an underwriter would view and rate 2 risks of say $20 Million in essentially the same

[31] Paragraph 34.2(c) of the Application.
[32] Paragraph 34.2(b) of the Application.

way as 1 risk of $40 million." In other words, the claimed savings in insurance premia could largely be achieved under the counterfactual where two separate risks would be insured. Sutton McCarthy submitted that the insurance saving would be likely to be in the range of $10,000-40,000 p.a.

447. However, McKay subsequently provided the Commission with written confirmation of his position. In particular, he noted that because of the limited nature of the market for volcanic eruption insurance, "[i]f you have one legal entity with a single sum insured then the exposure and the premium will be significantly less than if you have two legal entities with the same sum insured." This suggested that the claimed savings in insurance premia were likely to be genuine – that is, they would not correspond to a reduction in coverage – and that they would be likely to be available only as a result of the proposed acquisition proceeding.

448. In light of the evidence from Willis Corroon, the Commission considers that these savings appear to be reasonable. It seems 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. Therefore, the Commission has accepted a combined cost saving of $192,000 p.a.

ii) Management and directors

449. The Applicant noted that 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 general manager will be required."[33]. In Appendix 16 of the Application, the Applicant projected that savings for 2001 in Board Expenses and Director Fees would amount to $[ ], and that savings from unified finance and management functions would amount to $[ ].

450. The Applicant accepted that there would be limited opportunities for the combined entity to make savings in on-mountain staff costs, because it would require a similar number of staff to operate lifts and other facilities as would the two separate operators. However, the Applicant claimed that some savings would be available as a result of having a single Board and unified management for the two fields.

451. RAL provided Base Year (2000) budgets for Board Expenses and Directors Fees at both ski fields combined. These are set out in Table 15, along with the claimed expenses associated with the combined entity. Total expenses and fees at the two ski fields was given as $[ ], whereas the Applicant claimed that the figure for the combined entity would be $[ ]. This saving of $[ ] includes the elimination of fees that would have been paid to Turoa Directors $[ ]. A further saving in Turoa Board expenses $[ ] would be partially offset by an increase in RAL Board Expenses $[ ], which would reflect an expected increase in the number of Board meetings. The Applicant intended to run both fields under the existing RAL Board.

[33] Paragraph 34.2(f) of the Application.

TABLE 15
Board Expenses and Director's Fees (2000)

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

452. The TSR Annual Report for the year ended 31 October 1998 showed 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 here. However, the 1997 season at Turoa (when 157,500 days were skied)[34] appears to be similar to the projected 2000 season (since the Applicant's baseline assumed that 160,000 days would 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 for directors' fees seems reasonable. The Commission has therefore adopted a saving in Directors fees of $50,000.

453. RAL envisaged that the position of General Manager and Finance Manager at Turoa would be eliminated as a result of the proposed acquisition. RAL said that the combined entity would require only one of each position. According to information provided by RAL, the removal of these two positions at Turoa would result in a saving of $[ ] p.a. An additional saving of $[ ] was claimed as a result of the merging of human resource and marketing functions.

454. While the Commission considers that 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 the 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,[35] the Commission has not been convinced that the annual saving of $[ ] can be claimed in its entirety. As a result, the Commission has accepted a figure of $100,000 for senior management savings, and $20,000 for the HR/Marketing savings.

455. In its Draft Determination, the Commission provisionally accepted aggregate cost savings in this area of $170,000 p.a. No new information was provided either in submissions or at the Conference to suggest that a change to this position was required.

[34] See Appendix 17 of the Application (Historical Statement of Financial Performance).
[35] 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.

iii) Administration

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

457. 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 would be able to deal with the Turoa operations within existing budgets. The Commission notes that the Applicant's expenditure projections did not allow for additional resources in the "Finance & Admin" category. To the extent that additional resources would have to be employed in this area to cope with the additional workload arising from the combined operation, the net cost savings would be diminished.

458. Again, no new information was provided in submissions or at the Conference to suggest that a change from the Commission's Draft Determination is warranted. As a result, the Commission has accepted a savings figure of $27,000.

iv) Purchasing power

459. In the Application and subsequent correspondence, RAL informed the Commission that savings of around $[ ] would be available to the combined entity through joint management of food and beverages, and of retail products. Specifically, "seasonal contract negotiations and purchasing for these activities (would be) principally handled from one field rather than two."[36]

460. RAL noted that these savings related to wage costs rather than to any discounts the combined entity might be able to extract from suppliers as a result of enhanced purchasing power. Such discounts, to the extent that they would be given by domestic suppliers, would be likely to be viewed as transfers, and in recognition of this, the Applicant did not factor them into the claimed savings.

461. No new information in this area was provided to the Commission since its Draft Determination. The Commission has therefore accepted a cost saving of $12,000 p.a.

Summary of Cost Savings

462. Having considered the views expressed in submissions and at the Conference, the Commission is of the view that no changes to the savings accepted in its Draft Determination are warranted. Table 16 summarises the savings in both capital and operating costs that have been accepted by the Commission as being likely to arise from the proposed acquisition.

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

TABLE 16
Summary of Accepted Cost Savings, 2001-05

	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 saving:	401,000	401,000	401,000	401,000	401,000
Total savings accepted	**566,000**	**401,000**	**401,000**	**401,000**	**401,000**
Total savings claimed*	[ ]	[ ]	[ ]	[ ]	[ ]

* Excluding savings arising from deferred capital expenditure.

Increased Output

463. 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).

464. According to the Application (p. 30):

> "[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;
> - 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."

465. Appendix 16 of the Application contained revenue projections for the combined fields over the period 2001-05. The Applicant expected 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 represented an increase of 12.5% on the combined projection for the two fields in 2000.

466. After 2001, the Applicant expected the number of skier-days to increase by 4,820 each season. These projections are set out in Table 17.

TABLE 17
Claimed Incremental Skier-Days, 2001-05

	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		**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

467. The Applicant presented its projections of additional skier-days over the period 2001 to 2005 against a baseline for the year 2000. The Applicant's baseline in 2000 was an expected 425,000 skier-days for Whakapapa and Turoa combined. This was broken down into the number of days skied by season pass holders (193,000) and the number skied by day pass holders (232,000). In making its projections, the Applicant assumed that in the first year, season pass skier-days would increase by 19%, and day pass skier-days by 6%, as a result of the proposed acquisition. Then in each of the following years, the total number of domestic skier-days at the combined fields was expected to increase annually by 2,320 days, while the number of international skier-days was expected to increase annually by 2,500 days.

468. In its response to the Commission's Draft Determination, the Applicant submitted that these projections were both reasonable, and were dependent upon single ownership of the two ski fields. These projections, and their nexus with the proposed acquisition, are discussed below.

469. 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 made a number of "adjustments" for volcanic activity in the 1995 and 1996 seasons, which raised the average to 355,140.

470. 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; in 1993, 435,280; and in 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 because of lack of snow, particularly 1998 when a total of only 59,000 skier-days were recorded.

471. The Applicant's baseline figure of 425,000 skier-days on both fields in 2000 is based on "average snow cover" as described above. The Mt Ruapehu ski fields have not had such snow cover since 1995.

472. In light of the earlier discussion regarding NIWA's views on likely snow conditions over the next five years as described above, the Commission has accepted 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

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

473. As the Applicant quantified separately the expected increase in output in terms of the increases in the number of days skied by domestic day pass holders, season pass holders, and international skiers, each of these is now considered in turn.

474. 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 projected a first year increase of 6% in this number, or 13,920 days. A further 1% annual growth was claimed for subsequent years through to 2005. The factors lying behind these increases were broken down as follows:

- the introduction of 'seamless' lift passes, which in the first year accounted for 4%, or 9,280 days;
- the development of a traverse linking the two fields, which in the first year accounted for 2%, or 4,640 days; and
- the traverse, which in years 2-5 would account for further growth of 1%, or 2,320 days.

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

476. In the Application, RAL 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 assumed that on those days where one field was closed and the other open, 50% of the skiers who would otherwise have skied at the closed field would 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 in 1994 was 2,295, while for a weekday (outside the holidays) the average number was 810 per day. Therefore, if Turoa was closed on a Saturday, while Whakapapa remained open, the Applicant believed 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.

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

478. The remaining 2% (4,640 days) were attributed by RAL to the development of the free guided traverse. This traverse would be more attractive to skiers if they were to have a seamless lift pass, as they would be able to ski at both fields in one day. RAL forecast that up to 1,000 skiers would make the guided traverse each day, and factored into its benefit estimates the cost of providing additional guides. The traverse is expected to take approximately 45 minutes to complete.

479. RAL also factored in an additional growth in day pass skier-days of 1% over each of the subsequent years after the first, this being based on the promotion of the guided tours linking the two ski fields. This growth amounted to an additional 2,320 skier-days for each year between 2002 and 2005.

480. As RAL noted in its submission, "it is necessary to focus on the whole package as it is hard to pinpoint just how many people will be attracted by a specific feature. Having said that, it is helpful to examine each development to explain why RAL thinks it will attract additional skiers and what the numbers are based on."

The Commission's View

481. The Commission's Draft Determination focused on each of the components mentioned above, such as seamless passes and the traverse, in order to build up a picture of the likely impact of the proposed acquisition on skier-days. A number of points were made with respect to the Applicant's approach, which are now reconsidered.

482. First of all, it may be unrealistic to assume that on each day that Turoa is closed but Whakapapa is open, that 50% of those skiers who would have skied at Turoa (had it been open) would travel to Whakapapa to ski. 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.

483. 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 are likely to be such that it would be unlikely that the proposed numbers switching 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 would appear to be unlikely.

484. Second, and more importantly, a seamless pass is likely to hold limited additional appeal for day pass skiers, as they have the choice of field irrespective of whether the fields are jointly or independently owned. A significant proportion of the Applicant's

claimed increase in domestic day pass skier-days (9,280 days of a total of 13,920 days in 2001) is based on the analysis of closed days discussed above. However, weather conditions are less likely to pose problems for skiers who purchase a day pass on the day. They can decide which field to ski at early in the morning, based on widely available condition reports and weather forecasts. If, for example, skiers staying in Ohakune learn that conditions are forecast to be more favourable at Whakapapa, they can easily travel to ski at Whakapapa. This ability of skiers to choose between fields on the day will tend to reduce the benefit claimed for the proposed acquisition.

485. In the Application, RAL referred to the transaction costs of dealing with two separate ski fields, noting that they are a significant disincentive for many skiers. These costs appear to relate to the hiring of ski equipment at field A, and then subsequently transferring to and skiing at field B, which would incur the inconvenience of having to return the rental equipment to field A. However, the Commission believes that these transaction costs are likely to be small. Most of the equipment hired at the ski fields is hired on a day-to-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.

486. 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 equipment 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 that they are not using the equipment for that day, and the charge is reduced commensurately. The difficulties alluded to by the Applicant in returning rental equipment under the counterfactual are unlikely to be significant, in the Commission's view.

487. In any case, the return of rental equipment hired from the other field does not appear to be an insurmountable problem under separate ownership. During the winter 2000 season, RAL opened an office in Ohakune along with a bus service from the office to the Whakapapa ski field. It appears that this service could easily be used to return RAL skis and other equipment hired by Whakapapa skiers who switched on the day to Turoa.

488. The Applicant maintained that the Commission had underestimated the importance of the need to reduce the inconvenience associated with skiing. In paragraph 109 of its submission, the following comment by the Receiver, Mr Traveller, is quoted: "Queuing to purchase lift passes is a deterrent to skiers – the hassle factor is high and consequently the transaction cost to the skier is high."

489. However, a day pass skier must purchase a day pass irrespective of whether the pass is for a single field or for both fields. When this purchase is made at the start of a skiing day, there is no reason to suggest that the "hassle factor" associated with the counterfactual of separate ownership will be any higher than under the proposed acquisition.

490. Related to this is the question of the movement of skiers between the two fields within a particular day. According to the Application (paragraph 36.18):

> "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)."

491. 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 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 the Whakapapa ski field is 50 kms. In addition, the road from Ohakune 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, is likely to deter skiers from moving to the other field, once a decision has been made to purchase a day pass. In addition those same skiers will then face additional travel at the end of the day.

492. The Applicant also indicated that a bus service between the two fields would be provided by a single owner. However, as noted above, the Commission understands that regardless of the proposed acquisition, RAL is about to or has commenced 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 would tend to indicate that a discounting of the net benefits claimed for the proposed acquisition is appropriate.

493. Most of the comments made in response to the Commission's discussion on day passes focused on the attraction of the proposed guided traverse between the two ski fields, and the flexibility it would provide to skiers, including day pass holders. For example, the Ruapehu District Council (0694) submitted that:

> *"[s]eamless lift passes would give skiers greater variety by offering the chance to ski two fields – including on the same day using the proposed traverse. ... The proposed traverse between the skifields offers the unusual attraction of being able to ski two fields in a single day. The novelty of this attraction would increase visitor numbers."*

494. Similarly, Wendy and Peter Lewis (0325) responded to the Commission's Draft Determination (regarding the likely increase in domestic day pass skier-days), noting that:

> *"[w]hile the two fields are on the same mountain, they often have different weather conditions, depending on the weather pattern of the day. The ability of skiers from Auckland, for instance, to travel to Whakapapa use the lift system there and then traverse to the Turoa field to experience that field and then either traverse back or use the bus suggested will greatly enhance the attraction. The same would apply to Wellington skiers with the Turoa field."*

495. The September 2000 survey of skiers at Whakapapa and Turoa provided additional support for the attractiveness of a free guided traverse. According to the results, 88% of those surveyed indicated that such a traverse would make Mt Ruapehu a more attractive destination. Of those, approximately half said they would ski more days as a result of the proposed traverse. The survey report noted (page 37) that "'beginners', and to some extent day pass users … were those most likely to say they would ski for more days if a free guided traverse were available."

496. The Applicant 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. 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 the likelihood of such a development.

497. In light of the evidence contained in submissions and the September 2000 survey, the Commission accepts that the proposed traverse, in conjunction with the ability to ski on both fields under the same pass, is likely to be an attractive feature to day pass skiers. However, in addition to questioning the size of any impact of the traverse on skier-days, the Commission must also be satisfied 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 face a commercial incentive to cooperatively provide 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.

498. The Commission has considered whether the creation of the linkage by separate owners and the consequent pricing for use of that linkage would give rise to concerns under the Commerce Act. The Commission has likewise considered whether the development of seamless day passes by separate owners gives rise to the same competition concerns. As noted in the earlier discussion on the counterfactual, the Commission is of the view that it would be reasonably straightforward to develop the traverse through a joint venture between two separate owners, and that this in itself would be unlikely to raise any competition concerns due to the likely exemption available under section 31 of the Act. This suggests that the benefits generated solely by the traverse could be available under the counterfactual.

499. However, the Commission also concluded that any benefits resulting from a seamless day pass are more likely to emerge under the proposed acquisition than under the counterfactual.

500. As indicated by submissions, there is likely to be some benefit from having a traverse available *in conjunction with* a seamless day pass. In other words, the appeal of a traverse would to an extent be contingent upon a seamless day pass also being available, allowing skiers to ski both fields without having to descend from the mountain in moving between the fields. The ability to do this appears to be very attractive to day pass skiers, as suggested by the results of the September 2000 survey noted above. Given the Commission's view that such a seamless pass is more likely to be a feature of the proposed acquisition than the counterfactual, this suggests that some of the benefit claimed from the traverse should be accepted.

501. The increase in domestic day pass skier-days attributable to the traverse is claimed to amount to 4,640 days in 2001, and to be a further 2,320 days per annum thereafter. The Commission accepts that a proportion of this figure can be attributed to the proposal, due to the attraction of the traverse being available in conjunction with a seamless day pass. A figure of 4,000 days has therefore been accepted.

502. One further point relates to the possible migration of day pass skiers to season passes. If the number of season pass holders were to increase as a result of the proposed acquisition, this may be at the expense of day pass sales. For example, if the traverse were in fact to make season passes more attractive, then skiers who previously had

purchased day passes would be likely to purchase a season pass instead. This would tend to reduce the net increase in skier-days as a result of the proposed acquisition, and the Commission has attached some weight to this influence.

Conclusion on Day Pass Skier-Days

503. In terms of the likely impact of the proposal on domestic day pass skier-days, the Commission has ignored the 'closed day' effect. The Commission accepts that the free guided traverse, in conjunction with a seamless day pass, may result in some increase in the number of days skied by domestic day pass skiers, although this may be mitigated by the fact that some of the claimed benefit may be available under the counterfactual through joint venture provision of the traverse.

504. The Commission has therefore decided to discount most of the claimed increase in skier-days by domestic day pass holders as a result of the proposed acquisition. The Commission considered retaining the range of discounts adopted in the Draft Determination, specifically 75-100%. However, the Commission believes that the combination of a traverse and a seamless lift pass will generate some genuine net benefit over and above the counterfactual. The Commission has therefore accepted a range of 3,000 – 4,000 additional domestic day pass skier-days in 2001, increasing thereafter by 500 days per annum.

TABLE 18
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
Accepted Range	3,000-4,000	3,500-4,500	4,000-5,000	4,500-5,500	5,000-6,000

Increase in Days Skied by Season Pass Holders

The Applicant's Claim

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

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

506. RAL claimed that season passes would be more attractive as a result of holders being able to ski at either field in response to personal wishes and to weather conditions. Season pass holders, who would otherwise be committed to one field, would be encouraged to ski on those days when one field is closed and the other open. From its earlier analysis of closed days on the mountain, the Applicant claimed that this would translate into a 4% increase in days skied by season pass holders.

507. RAL also claimed that the traverse would lead to a further increase in season pass skier-days. This increase was estimated by RAL to be approximately 11,580 days in 2001, a 6% increase over the baseline figure for 2000.

508. The final component of the 19% increase claimed by the Applicant resulted from the claim that existing season pass holders would ski more days on average than they otherwise would be the case. The reasons advanced were the same as those above, namely, the access to both fields. According to additional information provided by the Applicant, RAL assumed that existing season pass holders would increase the number of days they ski by 9% (0.64 days) on average. This would translate into an additional 17,280 days in 2001.

The Commission's View

509. In its Draft Determination, the Commission accepted that a season pass which provides access to both ski fields may generate additional skier-days, although it noted that the magnitude of any increase was subject to considerable uncertainty, as was the causal link between the increase and the proposed acquisition. The Commission, at that stage, was not 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. As a result, the Commission discounted the claimed increase in season pass skier-days by between 75% and 100%.

510. Based on the later submissions received by the Commission, it appears that the proposed introduction of a seamless season pass priced at $239, combined with a free guided traverse, would be a significant attraction to skiers. Many people indicated that they would ski more often if these new features were to be introduced.

511. For example, Mr David Killick (0521) stated that:

> ". . . a seamless season pass to both ski fields would be an advantage to skiers as it increases the options for skiing Ruapehu. Currently being "tied" by a season pass to one field is limiting as some days I wish to ski the other field due either [sic] weather, snow conditions, facilities operating, events happening or just for something different. This year I have a season pass for Whakapapa, I have spent 5 days there and chosen to ski Turoa another 2 days. The days at Turoa have cost me extra as I have had to purchase day passes and this additional cost ultimately reduces the number of days I ski."

512. Mr Warren Goff also said that he:

> ". . . would welcome the variety of skiing that would be available by being able to ski both sides of the mountain on one ski pass. We would also appreciate the opening up of much more skiable terrain by having the opportunity to ski over to the other ski field and back again when conditions allow."

513. The earlier discussion on the counterfactual considered the likely extent to which the claimed increase in season pass skier-days would be possible in the absence of the proposed acquisition. The conclusion drawn there was that a significant proportion of the benefits are tied to the proposed acquisition proceeding, and can therefore be

counted as a genuine public benefit. These benefits will accrue through the increase in the number of skier-days.

514. As noted earlier, the Commission believes that a traverse between the two ski fields could well be a feature of the counterfactual, provided through a joint venture arrangement. As a result, some of the benefits claimed by the Applicant have been discounted. In terms of quantifying this discount, the Commission has based its position on the Applicant's claimed increase in skier-days attributable to the traverse, and has removed some of this from the total. Again the Commission recognises that the traverse, combined with a seamless pass, is likely to be attractive to skiers.

515. The Draft Determination noted that there may have been some double-counting of benefits. The Applicant assumed 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 ski at the other field when one field is closed, and the guided traverse. As a result, an existing season pass holder who moves to Whakapapa when Turoa is closed, and thus skies an additional day, appears to have been captured twice by the Applicant.

516. In the Draft Determination, the Commission's main concern in relation to seamless season passes was that the claimed benefits were likely to be available under the counterfactual through a cooperative approach between separate owners. As a result, the Commission initially discounted the claimed increase in season pass skier-days by 75-100%. However, the Commission is now of the view that the claimed benefits are more likely to be available under the proposed acquisition than under the counterfactual.

Conclusion on Season Pass Skier-Days

517. In light of the above discussion, the Commission has decided to place more weight on the claimed benefits associated with season passes. The Commission has accepted that the benefit in terms of additional skier-days by domestic season pass skiers is likely to be in the range of 20,000-25,000 skier-days. This is equivalent to each season pass holder (of which there were approximately 27,000 in the 2000 season) skiing an additional 0.7-0.9 days per season.

TABLE 19
Additional Skier-Days by Domestic Season Pass Skiers
(compared to baseline at 2000)

	2001	2002	2003	2004	2005
Claimed	36,662	36,662	36,662	36,662	36,662
Accepted Range	20,000-25,000	20,000-25,000	20,000-25,000	20,000-25,000	20,000-25,000

Increase in Days Skied by International Visitors

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

518. 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.[37] This compares with a figure of 45% for the South Island fields in 1999. The Applicant stated that the main reasons why so few international skiers visit Mt Ruapehu are the lack of a "destination" and the unreliability of the weather.

519. In the Application, RAL placed 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 estimated that the merger of the two ski fields on Mt Ruapehu would, in combination with additional marketing effort, attract an additional 500 visitors from overseas to Mt Ruapehu in the first year, who would each ski on average five days. A further additional 2,500 skier-days would be attracted to the mountain on each subsequent year, so that the total would reach 12,500 days by Year 5 (2005).

520. The Applicant based its predictions on a number of factors. In particular, reference was made to an interview with Mr Euan Purdie (Tourism New Zealand), in which Mr Purdie 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, followed by 1,000-1,500 within a couple of years after that, with gradual growth thereafter. He said that an average of five days skiing per visitor seemed reasonable.

521. Similar comments were made by other parties contacted as part of the Commission's investigation. A number of Australian-based tour operators stated that the promotion of Mt Ruapehu as a whole would be more likely to attract Australian visitors to the region than separate campaigns focusing on the individual ski fields. A combined Whakapapa/Turoa would provide several attractive features: the largest ski area in the southern hemisphere; a greater variety of terrain that could be skied under a single pass; and the fact that skiers would be less susceptible to Mt Ruapehu's variable weather, as they would be able to ski at either field. 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.

522. RAL also referred to the joint marketing campaign undertaken with TSR to attract overseas visitors over the period 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.

[37] Page 17, Whakapapa 1995 Survey, see note 1.

523. At the Conference, Mr Mazey observed that the 1993-1995 joint marketing campaign:

> "... could be regarded as a successful campaign, but it was not, and it will never be, as successful as can be achieved … through a focused single campaign … there are natural constraints in trying to get two competing companies working together. … But to me, and all the evidence that we've got … the results that you can achieve from focused, committed allocation of resources into that activity from a single owner will be significantly greater."

The Commission's View

524. The Commission's Draft Determination questioned whether the claimed increase in the number of days skied by international skiers could be achieved in the absence of the proposed acquisition. The Commission pointed to the success of the above-mentioned joint campaign in Australia. According to Mr Williams, that campaign attracted approximately 600 visitors to Mt Ruapehu in 1993, with an average stay of 8-9 nights. The results of that campaign, in terms of visitor numbers and estimated skier-days, are set out in Table 6. In 1994, the number of visitors increased to just under 1,000, and the following year, 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.

525. That joint campaign suggests that separate ski field operators may be able to market Mt Ruapehu cooperatively as a ski destination, and to attract overseas visitors. However, as noted earlier, the Commission's view on the likely counterfactual is such that a joint campaign run by separate owners to promote the mountain in overseas markets will be less effective than the efforts of a single owner. The Commission is of the view that a joint campaign under the counterfactual will carry a risk that the necessary cooperation will not materialise, or will be limited, and therefore may be less successful that one carried out by a single owner. The earlier discussion on the counterfactual highlighted some of the problems experienced in the previous campaign over 1993-1995.

526. To reflect this, the Commission has accepted some of the additional international skier-days claimed by the Applicant, recognising that these would be over and above the increase that might be achievable by a joint marketing campaign run by the two separate ski field operators in the counterfactual. This margin reflects the advantages of only one ski field owner combining with other parties, such as hotels and wholesalers in a joint marketing campaign.

527. The Commission has also considered the issue of the extent to which the claimed additional international visitors would actually be additional to New Zealand. 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 would be largely offset by the losses at the South Island fields. The benefit has to be assessed in net terms for New Zealand as a whole.

528. Value Tours, a major Australian tour wholesaler, commented that some skiers who would be 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 called the 'soft skier' who travels on a winter holiday that may include a few days skiing. However, other skiers may otherwise have skied elsewhere in New Zealand. Mr Purdie expressed a similar view, in 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 switching between New Zealand ski

fields, it is likely that some switching will occur, at least in the early stages of a marketing campaign.

529. The NZIER argued in its submission (page 22) that such transfers were unlikely:

> "Current South Island skiers represent only a very small proportion of the potential pool from which the additional overseas visitors to the North Island will be drawn. Given this there is no reason to conclude that a significant proportion of the additional overseas skiers in the North Island are likely to represent a transfer."

530. This is consistent with figures provided in the submission of Mr Purdie, who estimated that there were 500,000 skiers in Australia, of whom only approximately 27,000 skied in New Zealand in 2000. This suggests that there is a significant untapped market of skiers in Australia.

531. The NZIER contended that any skiers that would switch from the South Island to the Mt Ruapehu fields as a result of the proposed acquisition would be likely to be replaced by other international visitors, due to the "unfulfilled demand in the South Island". The Commission has not seen any evidence of this unfulfilled demand. Although there is limited international airline capacity direct into Queenstown, many international visitors fly into Christchurch, from where they travel to the South Island ski fields.

532. In the course of the Commission's investigation, the issue of international access to the Mt Ruapehu ski fields was raised. There was a perception that the lack of an international airport in the vicinity of Mt Ruapehu might inhibit any attempt to attract international skiers. However, this may not be a serious problem, as there is considerable spare capacity of international flights into Auckland and Wellington, and flights from Australia also land at Palmerston North. In contrast, Queenstown airport receives once-weekly flights from each of Brisbane and Melbourne, and twice-weekly flights from Sydney. Each flight carries approximately 110 seats. As noted above, given this limited capacity, most overseas skiers who visit Queenstown fly into Christchurch and then drive to Queenstown.

533. The Commission notes that the claimed benefits appear to be conservative, especially when the claimed increase in skier-days are placed in the context of the size of the Australian market. Mr Purdie has suggested to the Applicant that "with a serious marketing effort, 4,000-5,000 skiers (representing up to 25,000 skier-days) would be possible after four to five years."[38] The Applicant has claimed half this amount by the year 2005.

534. Tourism New Zealand commissions annual surveys of the five main ski fields in the South Island. According to the 1998 and 1999 surveys, approximately 25,000 Australian skiers visit the major South Island ski fields each year. In the 1999 season, these visitors accounted for an estimated 132,000 skier-days. Australians account for roughly half the total number of international skiers to those fields.

535. The number of Australian skiers visiting the five main South Island ski fields in 1998 and 1999, and the corresponding number of skier-days, are summarised in Table 20. Also included is an estimate of the same figures for 2000, given in Mr Purdie's submission. For 2000, the Commission has converted the estimated 27,000 skiers into skier-days using the average number of days skied in 1998 and 1999 of 5.7.

[38] Interview with Simpson Grierson and NZIER, see footnote 47, page 38, initial Application.

TABLE 20
Estimates of Australian Skiers at Major South Island Ski Fields, 1998-2000

	1998	1999	2000
Skiers	25,620	23,100	27,000
Skier-Days (est)	147,588	132,000	153,900

536. In 1999, the number of other international skiers at the five main South Island fields is estimated from Tourism New Zealand data to be 24,150, giving a total of over 47,000 international skiers. By comparison, the Applicant is claiming an increase in the number of international skiers of 500 in 2001 (which is equivalent to 1.1% of the current South Island total), amounting to an additional 2,500 skier-days.

537. It is reasonable to assume that the benefits will grow over time as a result of a sustained marketing commitment. Submissions such as those from Mr Cooper and Mr Purdie noted that marketing campaigns must be based on a long-term commitment. Mr Cooper submitted at the Conference:

> "Marketing is an investment, it's not cost, and that investment will often take time to reach maturity, and partners have to have commitment to marketing investment, particularly when they start marketing off-shore. That building alliances, building relationships takes time, and building understanding in the marketplace takes time. And it doesn't surprise me to hear that the joint campaign in the early 90's wasn't sustained, it takes time. It is not uncommon, for example, for tour operators to look three years out for the benefits of a collective marketing activity or a new product launch. Market development internationally takes time."

Conclusion on International Visitor Skier-Days

538. In light of the submissions and the evidence presented at the Conference, the Commission is now prepared to place some further weight on the claimed increase in days skied by international skiers attracted to Mt Ruapehu as a result of the proposed acquisition. The proposed acquisition is likely to be more effective in attracting such visitors, although there is a risk that a proportion of these visitors may otherwise have visited the South Island ski fields. The Commission has accepted 50% of the claimed benefits.

TABLE 21
Additional Skier-Days by International Skiers

	2001	2002	2003	2004	2005
Claimed	2,500	5,000	7,500	10,000	12,500
Accepted	1,250	2,500	3,750	5,000	6,250

Summary of Increased Output

539. The range of increases in skier-days discussed above are summarised in Table 22. The Table includes the increases claimed by the Applicant along with the ranges accepted by the Commission.

TABLE 22
Increases in Skier-Days (Compared to Baseline 2000)

	2001	**2002**	**2003**	**2004**	**2005**
Accepted:					
domestic	23,000–29,000	23,500–29,500	24,000–30,000	24,500–30,500	25,000–31,000
international	1,250	2,500	3,750	5,000	6,250
Total	**24,250–30,250**	**26,000–32,000**	**27,750–33,750**	**29,500–35,500**	**31,250–37,250**
Claimed:	53,085	57,904	62,724	67,544	72,364

Valuation of Skier-Days

540. In the Application, RAL valued the increase in the number of skier-days by using the average price of a day's skiing, which included the average price of a ski pass and the average expenditure on food and beverages (and other on-mountain services). The average revenue realised by the sale of a ski pass across all skiers was given as $[ ], excluding GST, while the average cost of the other items was $[ ]. This lead the Applicant to value an additional skier-day at $[ ]." The Applicant subsequently made a slight adjustment to this figure in light of updated estimates of expenditure on other on-mountain services. An allowance was then made for the additional costs associated with the increase in skier-days. In particular, the wholesale cost of additional goods sold was subtracted in order to express this measure of benefit in net terms.

541. The Commission's Draft Determination discussed at some length the Applicant's approach to valuing additional skier-days. Two main points emerged: the first related to the measure of surplus appropriate to the assessment of public benefits; and the second related to the distinction between domestic and international skier-days.

542. In the Application, RAL focused on measuring the benefit from increased skier-days as the increase in producer surplus generated to the business. This is only a partial measure of the public benefit stemming from the additional days skied. The total benefit will also include the impact on consumer surplus.

543. The Commission's view as to the appropriate valuation approach was set out in the Draft Determination, using Figure 3 given in the detriments section above. That Figure 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.

544. The shift in demand as a result of the acquisition has an impact on both consumer and producer surplus. Consumer surplus is the excess value to consumers of a given level of output, over and above the total revenue paid for that output. It is measured by the area under the demand curve and above the prevailing price. In Figure 3, at an initial output of Q_1, the level of consumer surplus is given by the area P_1EA; as demand expands to Q_2, consumer surplus increases to P_1FB. The increase in consumer surplus is measured by the heavily shaded area EFBA.

545. Producer surplus refers to the extent to which price is set above marginal cost. It reflects the revenue earned from the sale of additional units of output, less the additional cost of supplying that output. In terms of Figure 3, producer surplus at output level Q_1 is shown as the area P_1AGC; as demand increases to Q_2, producer surplus increases to P_1BHC. The increase in producer surplus is therefore equivalent to the lightly shaded area ABHG. This is the measure that was initially used by the Applicant to value the increase in skier-days.

546. The comments above are appropriate for valuing additional domestic skier-days, where the increases in both consumers' and producers' surplus represent gains to New Zealand. However, for additional international skier-days, any increase in consumers' surplus is irrelevant, as it accrues to foreigners and should therefore not be included. This follows from the Act's focus on the welfare of New Zealanders. In the Guidelines, the Commission made the following statement:

> "The term "public" in "public benefit" is taken to be the public of New Zealand. This means that benefits to foreigners are to be counted only to the extent that they also involve benefits to New Zealanders."

547. 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*. The Commission's general approach means that in valuing benefits to foreigners, no weight is attached to consumers' surpluses received by foreigner visitors in New Zealand.

548. A final point concerns the complementary services related to ski field operation. In its Draft Determination, the Commission expressed the view that additional domestic skier-days should be valued only in terms of the additional ski field services consumed. In the case of domestic skiers, expenditure on complementary services is likely to represent a transfer of spending from other areas within New Zealand. It is conceivable that such a transfer of expenditure could have a positive net impact on economic well-being, particularly where the transfer is in favour of a relatively deprived region such as the Ruapehu District. According to the submission of the Ruapehu District Council, on measures of socio-economic status Ruapehu "scores 9 out of 10 (where 1 is highest and 10 is lowest) and is the ninth most deprived district in New Zealand".

549. However, while recognising this possibility, the Commission considers that any effort by it to weight the income streams flowing to different groups or to different geographic regions would lead to it making highly subjective judgements, and would often involve data requirements far beyond what it would normally have access to. Hence, it is of the view that the distributional aspects flowing from business acquisitions should be treated as transfers of economic activity from one group or

region to another, where one gains at the other's expense, and where in consequence the welfare impact is assumed to be zero. The Commission believes that distributional issues are the responsibility of other government agencies.

550. In valuing domestic skier-days, the Commission has therefore focused on ski services only. However, it recognises that there may be an additional net benefit arising from the transfer of domestic expenditure from relatively affluent regions (such as those where skiers are likely to reside) to the Ruapehu District.

551. For international visitors, it is appropriate to value additional skier-days in terms of the additional expenditures on both ski services and other complementary on-mountain services provided by the combined entity, since such expenditures are likely to be at the expense of overseas businesses, and should therefore be counted as a public benefit to New Zealand. The analysis of international expenditure should therefore include spending on both categories of services.

552. According to the NZIER's submission, the Applicant amended its approach to the valuation of extra skier-days in line with that of the Commission. NZIER presented a range of valuations, depending on the assumptions made with respect to the elasticity of demand and the marginal cost, as well as to the predicted increase in skier-days.

553. The actual valuation of the increase in domestic and international skier-days involves quantifying the various parameters associated with Figure 3. 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. These are now discussed in relation to domestic and international skier-days.

Domestic Skier-Days

554. In valuing additional domestic skier-days the Commission has used, as above in the detriments section, the following: an average lift pass price of $[ ]; the baseline number of 425,000 skier-days at Mt Ruapehu; and the marginal cost per a skier-day (excluding complementary services) of $[ ]. The Applicant appeared to have accepted the use of these parameters, although as noted earlier, the NZIER estimated marginal cost to be $[ ]. The alternative values of marginal cost do not significantly change the results of the model. In the following analysis, a figure of $[ ] has been used. The two values for the price elasticity of demand of –0.5 and –1.0 are also used. The NZIER included its elasticity estimate of –2.1, derived from the September 2000 survey, but as discussed earlier, the Commission has placed little weight on that estimate.

555. The Commission has adopted a range for the increase in domestic skier-days as a result of the proposed acquisition. This range is 25,000-31,000 days per year by the end of the five year period. These bounds represent the extent of the rightward shift in the demand curve in Figure 3. Table 23 summarises the Commission's estimates of the value of the additional domestic skier-days.

TABLE 23
Estimates of Annual Benefit from Increased Output of Domestic Skier-Days in 2005

Assumed increase in demand (days)	Price elasticity of demand	
	-0.5	-1.0
25,000	$1,817,941	$1,175,846
31,000	$2,265,166	$1,463,508

556. 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 $1,175,846 to 2,265,166. This corresponds to the shaded area EFHG in Figure 3, assuming that the Figure relates only to ski field services.

International Skier-Days

557. For the purposes of valuing additional international skier-days, it is assumed now that Figure 3 relates only to foreign visiting skiers, and includes both ski services and other complementary on-mountain services. As discussed earlier, the aim is to estimate the area ABHG.

558. The Commission has accepted an increase in days skied by international visitors, amounting to an additional 6,250 days, by 2005. This is valued as the difference between the average expenditure on skiing and other on-mountain services and the additional cost of servicing that expenditure. The appropriate average expenditure figure for international visitors, adjusted to include GST,[39] is the Applicant's estimate of $[ ]. The additional cost of servicing this expenditure has been estimated from the Applicant's amended Appendix 15 to be $[ ]. This cost includes items such as the wholesale cost of additional goods and services sold, the expenditure on international marketing, and additional wages, including those associated with the guided traverse.

559. As a result, in 2005, the value of the increase in days skied by international visitors as a result of the proposed acquisition is estimated to be approximately $227,000 p.a. This corresponds to the area ABHG in Figure 3 above, and is not sensitive to changes in elasticity.

560. The Applicant appears to have used a similar approach to valuing additional international skier-days, although the NZIER's presentation of its results (Table 5, NZIER submission) suggests that the marginal cost estimates of $[ ] and $[ ] have been used. This appears to be a mistake, as those estimates of marginal cost relate solely to ski field services; as noted above, other complementary services should also be included, and when they are, a marginal cost figure of approximately $[ ] is

[39] 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.

derived. Again the NZIER includes its elasticity estimate of –2.1, although as discussed earlier, the Commission has placed little weight on this estimate.

561. Table 24 sets out the Commission's estimates of the value of the additional international skier-days as a result of the proposed acquisition.

TABLE 24
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	25,000-31,000	$1,175,846–2,265,166
International Skier-Days	6,250	$227,000
Total	**31,250–37,250**	**$1,402,846–2,492,166**
Claimed:	72,364	$2,320,000-4,927,000

562. 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. Because of the difficulties involved, such benefits have not been quantified as part of this Determination.

Benefits to the Region

Direct Benefits

563. In the Application (Appendix 15 and p. 40), the Applicant provided estimates of the "benefits to the region". The Ruapehu District Council's Economic Analysis of the Ruapehu District is appended to the Application. According to that report (p. 60):

> "The average estimated spend … per night in the Ruapehu District … for each international visitor is $150.00. This includes accommodation, meals, retail and leisure spending."

564. The average expenditure figure of $150.00 per night is based on an estimate from Tourism Waikato. The Applicant also referred in the Application to the New Zealand Tourism Board International Visitor Survey, which indicated that Australian visitors to New Zealand spend an average of $161.47 per day. The Applicant took the lower figure of $150.00 per day for its purposes.

565. The Applicant then deducted from that figure the average on-mountain spend ($[ ]), which, it was claimed, resulted 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.

566. In its Draft Determination, the Commission expressed its view that to the extent that this expenditure is made by foreign visitors who would not otherwise have come to New Zealand, this can be counted as a benefit. However, the Applicant's estimate needed to be adjusted to reflect the additional resource costs involved in meeting that extra expenditure. For example, in the case of the sale of additional food, beverage, and other retail goods at the ski fields, the Applicant made such an adjustment for the extra costs associated with increased skier numbers (see paragraph 35.6 of the Application). In that case, the adjustment amounted to between 40% and 60% of the additional expenditure on food, beverages, and related on-mountain services. For example, in 2001, the Applicant claims an additional 53,085 skier-days. On each of these days, skiers would spend on average $[ ] on food, beverages, and other on-mountain services. This would amount to total expenditure of $[ ]. The additional cost of meeting that expenditure was given in the Application (Appendix 15) as $[ ], which was about 60% of the gross expenditure. However, no such adjustment was made in the Application with respect to the off-mountain expenditure of foreign visitors.

567. Following the Commission's approach in the Draft Determination, the NZIER made an allowance for the cost of servicing the off-mountain expenditure by international skiers. As noted in its submission (p. 21): "One method to determine the cost of providing goods and services to tourists is to use information from the input-output tables of the New Zealand economy. In Statistics New Zealand's Tourism Satellite Account (1999) it calculates gross output of $[ ] and intermediate consumption of $[ ], or [ ] % of gross output."

568. In its Draft Determination, the Commission 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. In light of the above reference in the NZIER's submission, a figure of [ ]% is now considered to be more appropriate. Average expenditure ($150) less average on-mountain spend ($[ ]) is $[ ], inclusive of GST. Daily net expenditure is estimated to be [ ]% of this figure, or $45.06 per day.

569. The Applicant latterly introduced two important changes to the valuation of regional benefits flowing from additional international visitors. The first related to international skiers spending additional days in New Zealand when they do not ski, and the second concerned the use of economic impact multipliers to capture the "indirect" effect of the new expenditure.

570. The NZIER submitted (p. 21) that "most [international] travellers will be in New Zealand for at least two additional days, when they are not skiing. This is the most conservative assumption possible, assuming a day travel within New Zealand either side of the ski-trip. In practice, if a person is coming to New Zealand for five days of skiing they would most likely stay for an additional three to four days (particularly if coming from Australia where a nine day trip including two weekends is likely). So a successful marketing scheme for both fields that attracts international skiers that would not otherwise have come to New Zealand, would have benefits that exceed those originally calculated." The NZIER therefore claimed that an additional four days per international skier should be included as part of the assessment of regional benefits. The NZIER valued each of those days by applying the average expenditure ($150), discounted by [ ]% to reflect the cost of servicing that expenditure.

571. The Commission believes that while it is reasonable to allow for additional days travelling to and from Mt Ruapehu, it has seen no supporting evidence as to the

"average" number likely. Some visitors may travel directly to and from the fields, while others may take in additional attractions. However, in light of the dearth of evidence either way, the Commission prefers to adopt a conservative approach, and therefore has accepted an additional two days, rather than the NZIER's assumption of four.

572. The second change is the introduction of economic impact multipliers. Such multipliers are used to capture the second and subsequent round, or indirect, affects of new expenditure on output, household income, and employment.

Indirect Benefits

573. Indirect impacts are generated as a result of the linkages between sectors in the economy. For example, the direct expenditure by international visitors of $1 leads to an increase in output and income earned in other sectors that supply the goods and services purchased, such as the transport, catering, and accommodation sectors. The additional activity in those sectors in turn ripples through other sectors such as petroleum, food processing, and so on. This iteration of economic activity, stimulated by the new direct expenditure of $1, is encapsulated by the values of sectoral multipliers.

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

574. In its submission, the NZIER introduced output and income multipliers for the tourism sector, and applied those multipliers to the increase in direct expenditure. The output multiplier is a measure of the impact on gross output, and therefore a discount needs to be applied to reflect the consumption of intermediate goods. The NZIER used a figure of 40% for that purpose. This figure is based on industrial structure data which sets out the inputs used by each industry group. The NZIER applied the output multiplier to the claimed net expenditure of international skiers, that is, first having removed the cost of intermediate consumption associated with servicing that expenditure.

575. The income multiplier measures the impact on household incomes. As this measure focuses directly on household incomes rather than a gross measure, no discount has been applied to the income multiplier.

576. The NZIER referred to a report it had prepared for the New Zealand Tourism Board in March 2000, in which it discussed the multiplier effects arising from inbound tourism to New Zealand. According to that study, every $1 increase in expenditure by inbound tourism leads to a total increase in gross output of $3.777, and to an increase in household incomes of $0.697. These were the multipliers used by the NZIER in estimating the indirect benefits of the additional international skiers.

577. The NZIER estimated that new gross expenditure from international visitors would be $3,375,000 by 2005. This assumed an additional 2,500 international skiers, spending an average of nine days in New Zealand (five days skiing, and four days travelling to and from the ski fields), with an average daily expenditure of $150.

578. Using the above multipliers, the NZIER submitted that the total increase in gross output as a result of this new expenditure would be $12,732,000, from which a deduction of 60% was made to reflect intermediate consumption of inputs. A further deduction was made to remove the direct expenditure of the international skiers on ski

and other on-mountain services (estimated by the NZIER to be $451,000), which had been previously counted. This resulted in a "net" output expansion of $4,638,000. The increase in household incomes was given as $2,352,000 (0.697 x $3,375,000).

The Commission's View

579. According to the Commission's Guidelines,

> ". . . multiplier, second round or indirect effects may be relevant in public benefit analysis, but only to the extent that they result in net benefits to economic efficiency."

580. Multiplier effects may be accepted in public benefit analysis to the extent that they result in *net* benefits to New Zealand that would not have arisen in the absence of the acquisition. They should therefore only be applied to new expenditure. The valuation of the improvements in economic welfare generated by multiplier effects must be consistent with the way in which the Commission approaches the valuation of other benefits generally. At the same time, spending transferred from one domestic source to another is likely to have no significant net multiplier effect – the multiplier of the spending at the new source is likely to be offset by the cessation of the multiplier effect from the original source of the spending. Hence, only spending that is entirely new to the economy—that is, from overseas sources—is likely to be relevant.

581. The direct impact on welfare of the additional spending by foreign visitors equals the dollar amount spent less the cost of the inputs needed to produce the extra outputs purchased. It is the surplus of revenue over resource cost that is the benefit. To this extent, the NZIER's approach appears to be reasonable in that it focuses on new international expenditure, net of the resource cost required to satisfy this expenditure.

582. An important consideration is how "resource cost" is measured. In microeconomic analysis, it is commonly assumed that resources in the economy are fully employed. This would imply that any transfer of resources to new employments to meet new demand would entail an opportunity cost, in terms of the output foregone in their previous employment. This could be measured (at least approximately) as the factor payment in the new employment. However, in macroeconomic analysis the focus changes; here it is commonly assumed that there is unemployment of resources in the economy. As a result, unemployed resources can be absorbed into the production of the additional outputs, as the multiplier effect ripples through the economy. Their opportunity cost is likely to be substantially less than their value in their new-found employment, and possibly zero. If zero, then all of the indirect effects would count as a benefit.

583. A key issue that arises here is the extent to which multiplier or second round effects represent actual public benefits in the form of increased welfare. The NZIER recognised this issue in its submission, where they state that "although these multiplier effects will exist, translating them with any precision into a welfare impact is difficult." The NZIER went on to assess the welfare impact in terms of total returns to factors (through the output multiplier) and household income (through the income multiplier). The first approach provided what the NZIER regarded as an upper bound for the likely impact on welfare. This is an approximation of the increase in returns earned by capital and labour as a result of the new expenditure. However, it did not take into account factor ownership – it did not take account of the fact that some of the factors may be owned by foreigners. The corresponding benefit should thus be discounted to reflect this foreign ownership.

584. The second approach focused on the impact on household incomes. The income multiplier would seem to be the appropriate starting point for evaluating the indirect effects of additional foreign spending. It shows the impact on national income, in terms of the additional factor incomes (wages and dividends) accruing from resource use, of any new expenditure injection.

585. However, central to the multiplier concept is that the additional spending generates additional outputs, and with those, additional employment opportunities. There must be some unemployment or underemployment of resources in the economy; otherwise, the additional spending would be frustrated by capacity constraints and would merely be inflationary.

586. The Commission has decided, given the special circumstances in this case, to allow some benefit from the indirect effects of additional foreign spending. It has used the income multiplier as a measure of the indirect impact on welfare.

587. Following this approach, and using the Commission's estimates of the likely number of international skiers (1,250) and days spent in New Zealand by each (7), the new expenditure from international visitors is estimated to be $1,312,500 by 2005. This would generate a further indirect (or multiplier) effect of $915,000.

588. The multiplier impacts assume that there is sufficient excess capacity such that the opportunity cost of the additional resources employed in meeting the new expenditure is low enough to be ignored. However, if there were full employment, these opportunity costs would be significant, and once netted off, would lead to the indirect effects being considerably smaller.

589. The present case involves tourism in the Ruapehu District, where there appears to be considerable excess capacity. Additional tourists can presumably be accommodated with only small extra resource costs, with perhaps the bulk of additional spending being pure surplus (and thus pure benefit). For example, the Commission understands that occupancy rates in accommodation throughout the Ruapehu District are low. According to the Ruapehu District Council's Economic Survey, the overall occupancy rate for the Ruapehu District in March 2000 was approximately 18%, compared to a national figure of 36%. The Ruapehu District occupancy rate typically increases over the peak winter months. It reached 25% and 33% in August and September 1999 respectively. The assumption of excess capacity is therefore probably not unreasonable in the context of the present case. However, this assumption need not necessarily hold in other cases.

590. This suggests that the $915,000 derived above may be a reasonable approximation to the indirect benefit arising from the international visitors. However, the Commission recognises that the level of excess capacity, to the extent that it can be measured by indices such as occupancy rates, may not actually reflect the level of effective capacity that is available. For example, when looking at international visitors, it may be appropriate to focus on the high end of the accommodation market, which, in the case of the Ruapehu District, may run into capacity constraints earlier than the accommodation sector as a whole. In light of this consideration, and given the uncertainty over the correct value for the income multiplier in the first place, and over its final impact across the economy, the Commission has decided to accept indirect benefits in the range from $450,000 to $915,000.

Summary

591. Considerable care needs to be taken when considering the use of multipliers in any evaluation of public benefits. The direct expenditure to which multipliers are applied must be shown to be new expenditure to New Zealand, rather than being merely a transfer from one region to another.

592. In addition, the difficulties of translating indirect impacts into a genuine measure of improved economic welfare need to be recognised. A key issue is the need to net off the additional resource cost involved in satisfying the new expenditure, and this cost will depend on the assumptions made with respect to the alternative employment opportunities for the resources involved.

Summary of Benefits

593. In its submission, the NZIER summarised its estimates of the benefits arising as a result of the proposed acquisition.[40] These benefits are set out in the following table, along with those accepted by the Commission.

TABLE 25
Summary of Total Benefits (2005)

	Accepted Range ($ per annum)		Claimed ($ per annum)
Cost Savings	401,000	401,000	528,000
Increased Output (net)	1,402,846	2,492,166	2,320,000 – 4,927,000
Regional Benefits -			
- direct	298,000	298,000	
- indirect*	450,000	915,000	
- total regional benefits	748,000	1,213,000	2,352,000 – 4,638,000
Total	**2,551,846**	**4,106,166**	**5,200,000 – 10,093,000**

* Based on household income.

594. The Commission's view is that by 2005, the benefits arising from the proposed acquisition would be likely to fall within a range of $2,551,846 to $4,106,166 per year.

595. In addition, and as discussed earlier, the Commission has also 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.

[40] A subsequent note from NZIER to the Commission clarified and amended slightly the multiplier results.

Intangible Benefits

596. In its Application, RAL claimed a number of intangible benefits arising from the proposed acquisition. The first of these was the development and transfer of expertise between the two ski fields. For example, 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 in operating food, beverage and retail outlets. RAL also has more experience in the operation of detachable lifts.

597. In respect of this claim, the Commission considers that 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 involves pumping water through pipes from streams lower down the mountain. Snow making at Turoa is based around a reservoir sourced from snow melt and a small underground spring.

598. 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.

599. 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.

600. Secondly, the Applicant claimed 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.

601. 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. This may be accepted as an intangible benefit to the extent that a single owner of the two North Island ski fields is more successful than two separate owners in attracting new participants in the sport.

602. Finally, in addition to an increase in skier-days, the Applicant claimed that the proposed acquisition would lead to greater enjoyment as a result of the improved experience, for example, as a result of the introduction of a traverse. However, any increase in enjoyment is likely to be reflected in increased skier-days, and this has already been considered and valued as a benefit.

603. A number of submissions referred to additional intangible benefits that may arise as a result of the proposed acquisition. For example, Ruapehu District Council noted that business confidence throughout the District will improve, as RAL is a proven and reputable ski field operator. However, the Commission believes that any alternative purchaser would be likely to operate the ski field successfully.

BALANCING

604. The determination of the Application involves a balancing of the public benefits and the detriments that will, or will be likely to, result from the proposed acquisition. Only where the public benefits outweigh the detriments 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 thus be able to grant an authorisation for the proposed acquisition.

605. The Commission has made an assessment of the detriments caused by the acquisition of dominance and the benefits to the public arising from the proposed acquisition. The Commission's view is that the likely range of detriments from the proposed acquisition would be between about $620,000 and $2,780,000 per annum by the fifth year after the acquisition (2005), and that in the same year the likely range of the public benefits arising from the proposed acquisition would be between about $2,550,000 and $4,100,000 per annum.

606. The Commission notes that part of the reason for the ranges in detriments and benefits is uncertainty over the value of the price elasticity of demand for skiing, which led it to use upper and lower bound values, namely –0.5 and –1.0. Both the detriments and the benefits in aggregate are sensitive to the elasticity value used; in general, the lower the elasticity (in absolute terms), the larger are some of the individual detriments and benefits.

607. Consistency requires that detriments and benefits be balanced using estimates computed under the same elasticity assumption. Thus, detriments computed using an elasticity of –0.5 should be balanced against benefits computed using the same elasticity value, and likewise with the elasticity of –1.0.

608. The Commission has therefore balanced detriments and benefits for both of the elasticity values, by drawing on the information contained in Tables 13 and 25. This balancing is shown in Table 26.

TABLE 26
Balancing of Estimated Annual Benefits and Detriments for 2005 using Alternative Elasticity Values

Category	Elasticity = -0.5	Elasticity = -1.0
Detriments	$770,000 - $2,780,000	$720,000 - $2,060,000
Benefits	$3,193,941 - $4,106,166	$2,551,846 - $3,304,508

609. Table 26 indicates that the benefits are likely to outweigh the detriments arising from the proposed acquisition whichever of the two elasticities are used. The Commission believes that any intermediate value of the price elasticity of demand would generate the same outcome.

610. In undertaking the balancing exercise the Commission has also stood back from the strict quantification exercise, given the inherent uncertainties with some aspects of

this process. In the final analysis the Commission must make an overall judgment call on whether the public benefits are likely to outweigh the detriments.

611. In this case the Commission finds the quantification approach to be persuasive. While some of the detriments are clearly problematic to assess (see, for example, paras 357 and 387), wide ranges of detriment have been used to reduce the potential margin of error. In the case of public benefits, the Commission recognises that some are more susceptible of quantification than others. For example, the various cost savings are more readily measurable. However, other claims which are more speculative, or less susceptible of reliable quantification, have been discounted or disallowed. The approach taken has been conservative, again reducing the potential margin of error. Against this background, it is significant that there is no overlap between the detriments and benefits.

612. Accordingly, the Commission is satisfied that the acquisition by RAL of TSR will result or will be likely to result, in such a benefit that it should be permitted.

DETERMINATION

613. Pursuant to section 67(3)(b) of the Commerce Act 1986, the Commission determines to grant an authorisation to Ruapehu Alpine Lifts for the acquisition of the assets and operations of Turoa Ski Resorts Limited (in receivership).

Dated this 14th day of November 2000

M J Belgrave

Chair

APPENDIX A

List of Interested Parties

Cardrona Alpine

Maunganui Ski Field

Mr Garrick Workman

Mr Ian Heappey

Mr Jim Simpson

Mr Peter Sutton

Mr Richard Coon

New Zealand Ski Council

New Zealand Tourism Board

Ngati Rangi Trust

Ngauruhoe Ski Club (Inc)

nzski.com

Ohakune 2000

Rainbow Ski Area

Receiver, Turoa Ski Resorts Ltd (in receivership)

Ruapehu Alpine Lifts Limited

Ruapehu District Council

Sutton McCarthy Limited

Tongariro/ Taupo Conservation Board

Tourism Holdings Limited

Treble Cone Ski Area

Tukino Ski Field

Turoa Assets Limited

Tuwharetoa Maori Trust Board

List of Interested Parties who made Submissions at the Commission's Conference Held 18-20 October 2000

Mr Garrick Workman

Mr Peter Sutton

New Zealand Ski Council – Mr Miles Davidson

Ngati Rangi – Mr Piripi Haami and others

Ngauruhoe Ski Club (Inc) – Mr Philip Horrocks

Ohakune 2000 – Mr Dave Scott

Receiver – Mr Gary Traveller

Ruapehu Alpine Lifts Limited ("RAL") including:

- Mr Dave Mazey – General Manager
- Sir John Ingram – Trustee of RAL Trust
- Mr John Cooper – Tourism Business Solutions
- Mr John Feil & Dr John Yeabsley – NZIER
- Mr Robert Leach – NFO CM Research (NZ) Ltd

Ruapehu District Council – Mr Chris Ryan and Mr Weston Kirton

Sutton McCarthy including:

- Mr Keith Sutton – Director
- Mr Don Esslemont – Decision Research
- Dr Adolf Stroombergen – Infometrics Consulting