

Statement of Preliminary Issues

Trade Me Limited / Limelight Software Limited

24 July 2017

Introduction

1. On 11 July 2017, the Commerce Commission registered an application (the Application) from Trade Me Limited (Trade Me) to acquire up to 100% of the shares in Limelight Software Limited, trading as Motorcentral.¹
2. The Commission will give clearance if it is satisfied that the proposed merger would not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.²
4. We invite interested parties to provide comments on the likely competitive effects of the proposed merger. We request that parties who wish to make a submission do so by **7 August 2017**.

The parties³

5. Trade Me is an online marketplace and classified advertising platform, based in New Zealand. Relevant to the acquisition, Trade Me operates the "Trade Me Motors" business division, which includes:
 - 5.1 Trade Me Motors' provision of online vehicle classified advertising;
 - 5.2 AutoBase (an online vehicle classified advertising website);
 - 5.3 DealerBase (aggregator software for motor vehicle dealers); and
 - 5.4 MotorWeb (a provider of motor vehicle information and reports).
6. Motorcentral's primary business is the provision of dealer management system (DMS) software to motor vehicle dealers. DMS software helps motor vehicle dealers to manage purchasing, advertising and selling vehicles. For example, Motorcentral's

¹ A Public version of the application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

² The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

³ The Application at 4-11.

DMS includes services that allow dealers to: manage their vehicle inventory; keep track of customer enquiries; upload vehicle listings to online platforms (such as Trade Me and Facebook); and provide quotes for insurance.⁴ Motorcentral also provides other services including: a website design and maintenance service; and software that automates bidding on Japanese used-vehicle auctions.

Our framework

7. Our approach to analysing the competition effects of the proposed merger is based on the principles set out in our Merger and Acquisition Guidelines.⁵ As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.
8. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the with-the-merger scenario, also referred to as the factual), with the likely state of competition if the acquisition does not proceed (the without-the-merger scenario, also referred to as the counterfactual).⁶
9. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial sense.⁷
10. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the proposed merger might lessen competition. If the lessening of competition is likely to be substantial, we will not give clearance to the proposed merger. When making that assessment, we consider, among other matters:
 - 10.1 constraint from existing competitors – the extent to which current competitors compete and the degree they would expand their sales if prices increase;
 - 10.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 10.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

⁴ A fuller list of the functionality of Motorcentral’s DMS is in the Application at [3.5].

⁵ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. (“Merger guidelines”) Available on our website at www.comcom.govt.nz

⁶ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁷ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

Preliminary issues

11. The questions that we will be focusing on when assessing whether the proposed merger is likely to substantially lessen competition in the relevant markets are:
 - 11.1 would the merger reduce competition through eliminating the constraint that the two entities impose upon one another?
 - 11.2 would the merged entity be able to engage in behaviour that forecloses rivals and renders them less able to compete?

Without the merger

12. We will consider what the parties would do if the merger did not go ahead. We will consider the evidence on whether the without-the-merger scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding different partners to merge with or to develop their relationship through an agreement.

Would the merged entity be able to raise prices on its own?

13. Where two suppliers compete in the same market, a merger would remove a competitor that would otherwise act as a competitive constraint, potentially allowing the merged entity to raise prices or lessen quality.⁸ A merger could also reduce competition if one of the merging firms was a potential or emerging competitor. In such a case, the merger may preserve the market power of the incumbent firm.
14. There is existing overlap between some of the services that Trade Me and Motorcentral offer. For example:
 - 14.1 Trade Me and Motorcentral both offer website development and maintenance services;
 - 14.2 Motorcentral offers a DMS and Trade Me offers DealerBase which includes some DMS functionality; and,
 - 14.3 Trade Me and Motorcentral both offer vehicle information reports (Motorcentral through the integration of a third-party provider (CarJam) to its DMS).
15. The Applicant submits that the merger would not give rise to unilateral competition concerns as any horizontal overlap between the merging parties is not material.⁹
16. We will assess the degree of constraint that Trade Me and Motorcentral currently impose upon one another in the relevant markets. To the extent that any constraint

⁸ For ease of reference, we only refer to the ability of the merged entity to “raise prices” from this point on. This should be taken to include the possibility that the merged entity could reduce quality or worsen an element of service, ie, it could increase quality-adjusted prices.

⁹ See for example the Application at [1.4].

is material, we will assess whether the loss of competition between the merging parties could be replaced by rival competitors.

17. There are products that either Trade Me or Motorcentral provide where the other may be a future competitor. We will consider whether the threat of the other player entering is an important constraint on pricing in the market, and whether there are other potential entrants that could impose a similar constraint.

Would the merged entity be able to foreclose rivals?

18. A merger between suppliers can result in a substantial lessening in competition due to vertical or conglomerate effects. The proposed merger raises potential vertical and conglomerate effects.
19. At this stage, it is not clear whether the impact of the merger is best analysed as a vertical or conglomerate effect. This depends on whether the merged entity's services can be characterised as inputs or complementary services. We will identify the appropriate framework as our investigation progresses.

Vertical effects

20. The proposed merger raises potential vertical effects. A vertical merger is a merger between firms operating at different levels of a supply chain (eg. a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability and/or incentive to foreclose its rivals, including by refusing to deal with competitors completely (total foreclosure), or by raising prices it charges competitors (partial foreclosure).
21. The merger between Trade Me and Motorcentral would combine two firms that provide services at different levels of the supply chain. We will assess whether this might create the ability and incentive to foreclose rivals. Examples of how this might occur are as follows:
 - 21.1 The merged entity might attempt to use Motorcentral's DMS to foreclose Trade Me's rivals for motor vehicle advertising. The merged entity might pursue this by making it harder for Motorcentral's customers to use the DMS to book advertising with Trade Me's rivals.
 - 21.2 The merged entity might attempt to use access to Trade Me to foreclose Motorcentral's rivals for DMS software. The merged entity might pursue this by making it less convenient to book Trade Me advertising using other DMS providers or by withholding certain functionality within Trade Me from rival DMS providers (such as return on investment information).
22. The strategies described above could result in a substantial lessening of competition if rivals' costs are raised or rivals are reduced to a scale at which they can no longer provide an effective constraint against the merged entity. This may allow the merged entity to raise prices.

23. The Applicant submits that the proposed merger would not cause any vertical concerns.¹⁰ This is mainly on the basis that: Motorcentral would continue to operate in a highly competitive market; other advertising providers would still be able to receive vehicle listings through means other than Motorcentral's DMS; Trade Me would continue to have the incentive to receive listings from other providers of DMS; and integration is not critical to the provision of related services.
24. We will assess whether the merger would create the ability and incentive to foreclose upstream and downstream rivals. We will consider:¹¹
- 24.1 whether the merged entity would have the ability to foreclose, through having market power in one or more levels of the supply chain;
 - 24.2 whether the merged entity would have the incentive to foreclose, through earning additional profit from the strategy; and,
 - 24.3 whether the competition lost from any foreclosed competitors would be sufficient to have the likely effect of substantially lessening competition.

Conglomerate effects

25. A conglomerate merger is a merger between firms supplying products that may be complementary. Such mergers may, in certain situations, increase a merged firm's ability and/or incentive to foreclose competitors by, for example, bundling together complementary products, or by refusing to sell those services to customers unless they also buy a second service from it (tying).
26. Some of the services that Trade Me and Motorcentral offer could be viewed as complementary. For example, customers may view Trade Me's motor vehicle advertising service as complementary to Motorcentral's DMS service. This creates the potential for the merger to cause conglomerate effects. The merged entity could offer those services in a discounted bundle or tie one product to the other (that is, refuse to provide one service unless the customer purchased the other). This could result in a significant lessening of competition if the strategy raised rivals' costs or prevented rivals reaching a sufficient scale to provide effective competition.
27. We will assess whether the merger would create the ability and incentive to foreclose rivals through conglomerate effects. We will consider:
- 27.1 whether the merged entity would have the ability to foreclose, through having market power for at least one of the products in the bundle;
 - 27.2 whether the merged entity would have the incentive to foreclose, through earning additional profit from the strategy; and,
 - 27.3 whether the competition lost from the foreclosed competitors is sufficient to have the likely effect of substantially lessening competition.

¹⁰ See for example, the Application at [1.4].

¹¹ Merger Guidelines at 46.

Would the merged entity be able to coordinate with rivals to raise prices?

28. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power. Unlike a substantial lessening of competition arising from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.¹²
29. The merged entity may be able to collect information about its rivals. For example, Motorcentral's DMS may be able to collect information about dealers' purchases of services from Trade Me's rivals or Trade Me may collect information about Motorcentral's rivals. We will assess whether the proposed merger would provide Trade Me or Motorcentral with sensitive information about its rivals, and whether this might facilitate coordination.

Next steps in our investigation

30. The Commission is currently scheduled to make a decision on whether or not to give clearance to the merger by **5 September 2017**. However, this date may change as our investigation progresses.¹³ In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
31. As part of our investigation, we will be identifying and contacting parties we consider will be able to help us assess the preliminary issues identified above.

Making a submission

32. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Trade Me/Motorcentral" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **7 August 2017**.
33. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
34. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. For example, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.

¹² Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [3.84].

¹³ The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.