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COMMERCE COMMISSION

Decision No. 515

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

NEW ZEALAND MOTEL FEDERATION INCORPORATED

and

PACIFICA LODGES & INNS SOCIETY LIMITED

The Commission: **Denese Bates QC (chair)**
Donal Curtin

Summary of Application: The acquisition by New Zealand Motel Federation Incorporated (Best Western) of Pacifica Lodges & Inns Society Limited (Pacifica).

Determination: Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.

Date of Determination: 4 December 2003

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CONTENTS

EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to section 66(1) of the Commerce Act 1986 (the Act) was received on 17 November 2003. The notice sought clearance for an application from New Zealand Motel Federation Incorporated (Best Western) to acquire Pacifica Lodges & Inns Society Limited (Pacifica).

Market Definition

2. The Commission concludes that, for the purpose of analysing this application, the relevant markets are:

   - The national market for the provision of organisational services and branding to motels and motor inns (the motel services market); and
   - The national market for the provision of motel rooms to intermediaries in the wholesale market (the wholesale services market).

Counterfactual

3. The appropriate counterfactual is the status quo.

Competition Analysis

Existing Competition

4. The Commission considers that the merged entity will be constrained in the motel services and wholesale services markets by the presence of existing competitors who could respond rapidly in the event of a price increase by the merged entity.

Overall Conclusion

5. In the motel services and wholesale services markets, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, as there will be sufficient competition provided by existing competitors.

THE PROPOSAL

6. A notice pursuant to section 66(1) of the Commerce Act 1986 (the Act) was received on 17 November 2003. The notice sought clearance for an application from New Zealand Motel Federation Incorporated (Best Western) to acquire Pacifica Lodges & Inns Society Limited (Pacifica).

THE PROCEDURES

7. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Accordingly, an extension of time was sought and agreed to by the Applicant. A decision on the application was required by 4 December 2003.
8. In its application, Best Western has sought confidentiality for aspects of the application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
9. The Commission's determination is based on an investigation conducted by staff.
10. The Commission's approach is based on principles set out in the Commission's *Practice Note 4.*[1]

THE PARTIES

Best Western

11. Best Western is a society incorporated under the Incorporated Societies Act 1908. Best Western is authorised to license the use in New Zealand of the Best Western brand through an affiliation agreement with Best Western International Incorporated, a society incorporated in the United States of America.
12. Best Western's members are independent hotel, motor inn and motel accommodation providers. Best Western provide sales and marketing, reservations and support services to their members and licence their members to trade under the Best Western brand.
13. Best Western has two wholly owned subsidiaries – Nationwide Reservations NZ Limited (Nationwide) and Best Western Tours New Zealand Limited (Best Western Tours). Nationwide provides reservation management services to Best Western pursuant to a management agreement. Best Western Tours does not trade.

Pacifica

14. Pacifica is a society incorporated under the Industrial and Provident Societies Act 1908. Pacifica's members are independent hotel, motor inn and motel accommodation providers. Pacifica provides sales and marketing, reservations and support services to their members and licence their members to trade under the Pacifica brand.

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

Other Relevant Parties

Budget Motel Chain Limited (Budget)

15. Budget operates an online reservation service for over 500 member properties in New Zealand and Australia.

16. Budget is a voluntary organisation whose members are independent hotel, motor inn and motel accommodation providers. Budget provides sales and marketing, reservations and support services to their members and licence their members to trade under the Budget brand.

Mitchell CorpHotel Group Limited (Mitchell Group)

17. The Mitchell Group is a New Zealand owned company and operates the Mainstay and Golden Choice brands of motels and hotels. Golden Choice consists of both independently owned hotels, and hotels owned directly by the Mitchell Group. Mainstay consists of both independently owned motels, and motels owned directly by the Mitchell Group.

18. The Mitchell Group is a voluntary organisation and provides sales and marketing, reservations and support services to their members and licence their members to trade under one of its two brands.

AA Tourism Limited (AA)

19. AA is a division of the New Zealand Automobile Association Incorporated, an incorporated society of 930,000 members which provides a range of products and services to motorists.

20. AA operates a range of nationwide properties, including hotels, motor lodges, motels and holiday parks, through its AA Tourism Host Accommodation Programme. AA is a voluntary organisation whose members are independent accommodation providers. AA provides sales and marketing, reservations and support services to their members and licence their members to trade under the AA brand.

Flag Choice Hotels Limited (Flag Choice)

21. Flag Choice is a Melbourne based company and is a subsidiary of Choice Hotels International. Flag Choice introduced the Clarion, Quality, and Comfort accommodation brands into the New Zealand market in September 2003, and intends to convert most existing Flag Choice branded properties to one of these brands by March 2004.

22. Flag Choice is a voluntary organisation whose members are independent hotel, motor inn and motel accommodation providers. Flag Choice provides sales and marketing, reservations and support services to their members and licence their members to trade under the Flag Choice brands.

INDUSTRY BACKGROUND

Structure

23. There were a total of 1600 motel and motor inn properties and 562 hotel properties in New Zealand as at August 2003 according to a survey completed by the Tourism Research Council of New Zealand. Of this number, 456 properties are affiliated with the organisations listed in paragraph 11 to 22. Most of these organisations operate in a similar manner, in that the organisation is co-operative in nature and not involved in operating individual member properties. Mitchell Group, however, is privately owned and operates some of its properties directly, but also acts in a co-operative nature and is not involved directly in operating the majority of the properties that come within its brand.

24. The properties that are affiliated with the organisations vary in terms of their quality, number of rooms and style of accommodation. For example, motor inns typically have more rooms than motels, and hotels may offer more rooms than either. Also, self catering facilities will generally be available at motels and motor inns, while hotels and sometimes motor inns will provide a restaurant facility. However, generally speaking these accommodation types represent a similar service proposition to the market and thus the affiliated properties may be grouped under the broad category of motels. A small number of the affiliated properties are hotels, but these are generally smaller in size and of a lower quality that the hotels associated with the larger hotel chains mentioned below. For the purposes of this decision, the types of property represented by the parties in paragraphs 11-22 will be described as motels, and the parties themselves will be described as motel chains.

25. The majority of the remainder of motels and hotels not affiliated with the motel chains operate independently. A relatively smaller number of properties come within the umbrella of hotel chains which operate larger hotel properties. These hotel chains include:

    - The CDL Group (Millennium, Copthorne, Kingsgate);
    - Accor Group (Ibis, Novatel, Formula One and Mercure);
    - Scenic Circle Group;
    - Grand Chancellor Group; and
    - Intercontinental Group.

26. These chains are privately owned and operate their branded properties directly.

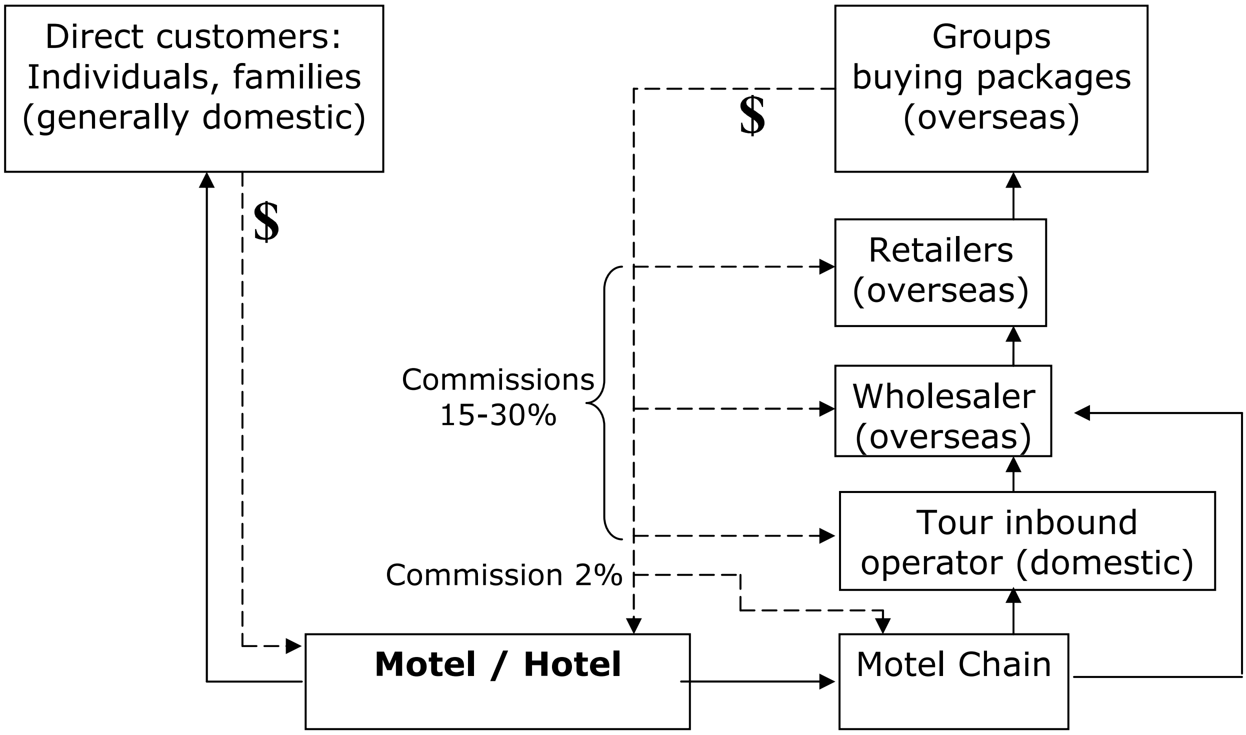
Relationship of Motel Chains with Motels

27. Motels who become affiliated with a motel chain are required to comply with specified quality standards and to pay membership and/or commission to their affiliated chain.

28. Motel chains interviewed indicate there are two primary channels for selling accommodation to tourists. The first channel relies on aggregators (wholesalers, inbound tour operators, travel agents) who package activities, accommodation and transport for tourists. Typically, these aggregators receive commissions ranging from 15%-30% of the purchase price of the accommodation. Motel chains indicate that, on average, aggregators account for between [   ] of total customers. The second channel

involves the accommodation provider selling directly to tourists. This channel is preferred by providers as no commission is paid to third party aggregators. Figure 1 shows a pictorial representation of these two customer channels.

Figure 1: The Motel Accommodation Sales Channels



29. Each accommodation provider sets its own tariffs for direct customers, and accepts a wholesale tariff negotiated by the motel chain ([ ]) for customers who book through the motel chain's reservation system. The wholesale tariff is typically reviewed annually.

30. Motel chains provide a number of services to their members, which can be summarised as follows:

- providing on-line reservations services for member properties. These provide central points through which rooms can be reserved at any member property, through the internet and 0800 telephone numbers;
- selling accommodation at member properties to travel wholesalers and tourist operators; both offshore and locally;
- operating payment systems for their members. For example, Best Western/Pacifica operates a system where travel wholesalers accept payments for and issue vouchers to individual travellers (usually through tour operators or retail travel agents). The travellers produce the vouchers in exchange for accommodation at member properties. The member properties return the vouchers to Best Western/Pacifica and are paid by Best Western/Pacifica. Best Western/Pacifica then returns the vouchers to the wholesaler and recovers payment from the wholesaler. At present

Pacifica charges a single flat rate for rooms booked through wholesalers. Best Western charges a tiered rate according to the standard of the property. For business other than that booked through wholesalers, however, each existing member property fixes its own tariffs;

- Licensing and authorising the use of their brands for marketing purposes by individual member properties; and
- providing membership support services to their members, such as advertising and marketing, maintaining websites, publishing group directories, providing signage and stationery, education and training, and monitoring specified quality control standards for the member properties.

31. Motel chains derive their income in part from the [ ] commissions on reservations and voucher bookings and in part from membership fees paid by individual member properties.

Relationship of Chains with Wholesalers and other Intermediaries

32. The motel chains sell rooms through wholesalers on behalf of their members. The major function of the motel chains is to provide members with a connection to the international tourist market through international wholesalers and other intermediaries which the individual accommodation providers could not afford to target themselves.
33. Motel chains deal with a large number of wholesalers – Best Western deals with [ ] and Pacifica deals with [ ] – and wholesalers in turn deal with most of the chains. Some, such as [ ].
34. As mentioned above, motel chains provide the wholesalers with a discounted accommodation rate. The wholesalers aggregate a range of services and products, including accommodation, and advertise these services and products though brochures, directories and other advertising medium. These are then are then sold to customers either directly by the wholesaler or by retailers such as travel agents.
35. Once a customer makes a booking, the wholesaler passes the information on to the chain who confirms availability with the individual motels. Bookings are confirmed within twenty four hours. Payment is made through systems such as the voucher system utilised by Best Western and mentioned in paragraph 29.

MARKET DEFINITION

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

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

37. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip*

test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

38. The Commission defines relevant markets in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);
- the level in the production or distribution chain (the functional level);
- the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
- the temporal dimension of the market, if relevant (the timeframe).

The Applicant's Market Definition

39. The applicant submits that the acquisition of Pacifica will result in aggregation in the market for the provision of accommodation in hotels, motels and motor inns.
40. The applicant submits that past decisions of the Commission have taken a broad view of market definitions in the tourism/accommodation industry because the tourism and accommodation markets cannot be defined narrowly.
41. The Commission considers that the market definition submitted by the applicant does not adequately describe the markets that would be affected by the acquisition. The applicant has proposed a definition which focuses on the activities of the member properties rather than the activities of the motel chains to which they are affiliated. The Commission has therefore decided to analyse the product markets based on the activities of the motel chains themselves.
42. The Commission has considered the demand-side and supply-side factors in the proposed acquisition and these are considered below.

Product Markets

Demand Side Substitution

43. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
44. For owners of motels and motor inns, the substitutes available to them in case of a small change in relative prices or quality are:
    - joining another chain; or
    - being independent.
45. The Commission considers that "being independent" may not be considered to be part of the relevant market as the services that independently owned properties can provide on their own do not compare with what is provided by motel chains in terms of nationally recognisable brands and reach into international and domestic tourist markets. However, the Commission considers that "joining another chain" is clearly an alternative open to all owners.

46. For wholesalers and inbound tour operators , the substitute services available to them in case of a small change in relative prices or quality are:

- using another chain of motels and motor inns;
- dealing with owners directly; or
- dealing with hotel chains and other providers in other market segments.

47. The Commission considers that "dealing with owners directly" is generally not a viable option for wholesalers, as it is too costly. However, the evidence provided by wholesalers suggests that they can easily decide to exclude certain chains from their list of dealings if they are not satisfied with the quality or price they receive from them. It is arguable whether the degree of substitutability between the major hotels chains and motel chains is sufficient to place them within the same market. The evidence of some motel chains is that the degree of substitutability varies as a function of demand, i.e. when demand is low then the major hotel chains lower their price so that they target customers who might otherwise only be willing to pay for accommodation in the motel segment. However, in the current case the Commission intends to exclude the services provided by the major hotel chains from the relevant market definition on the basis that if there are no competition concerns within a narrow market definition then there are unlikely to be any concerns within a wider market definition.

Supply Side Substitution

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

49. For the services that motel chains provide to owners of motels, on the supply side the substitute available to the motels in case of a small change in relative price is to become independent. However, as noted above, the level of branding and access to international tourist markets an independent motel provides itself is not comparable to that provided by a chain, and therefore the Commission does not consider this to be a supply side substitute.

50. Other providers of similar services on the supply side include the major hotel chains. However, these chains are vertically integrated and provide services exclusively to their own properties, and are therefore not a supply side substitute.

51. For the services the motel chains provide to wholesalers and inbound tour operators, the substitutes available in case of a small change in relative price are to use another form of accommodation provided by a different segment of the market, such as the major hotel chains. As mentioned above, although it is arguable whether this is a supply side substitute, the Commission has decided to adopt a conservative market definition and exclude these providers from the relevant market for the purposes of this analysis.

Conclusion on product markets

52. The Commission therefore considers the relevant product markets are:

- The market for the provision of organisational services and branding to motels and motor inns; and

- The market for the provision of motel rooms to intermediaries in the wholesale market.

Functional Market

53. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/ distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[2] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission seeks to identify separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each.
54. Best Western's operates in both the production and distribution of organisational services and branding, as well as the distribution of rooms to intermediaries. The Commission considers that the appropriate functional level is the supply of organisational services and branding and the distribution of rooms to intermediaries in the wholesale market.

Geographic Market

55. The Commission defines the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Adjacent geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.
56. The applicant considers both markets to be national. This is on the basis that the chains provide services on a national basis.
57. The Commission's investigations support this claim. Therefore, the Commission considers the appropriate geographic area to be national.

Conclusion on the Relevant Markets

58. The Commission concludes that, for the purpose of analysing this application, the relevant markets are as follows:

- The national market for the provision of organisational services and branding to motels and motor inns (the motel services market); and

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

- The national market for the provision of motel rooms to intermediaries in the wholesale market (the wholesale services market).

FACTUAL

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

60. In the factual scenario Best Western and Pacifica will merge and trade under a single and possibly combined brand. The rationale behind the merger is to [ ].

COUNTERFACTUAL

61. Pacifica has stated that [ ]. However, Pacifica has stated that it will continue to operate as a profitable business if the merger does not proceed. The Commission has been unable to identify any reason why Pacifica would not continue to operate as an independent organisation should the merger not proceed. The Commission therefore considers the appropriate counterfactual is that Pacifica and Best Western continue to operate as independent entities.

COMPETITION ANALYSIS

62. Having defined the counterfactual, the Commission assesses the following for each of the relevant markets:
    - the probable nature and extent of competition that would exist in the market, but for the acquisition (the counterfactual);
    - the nature and extent of the contemplated lessening in the factual by considering market concentration, existing competition and potential competition, and other competition factors such as countervailing power; and
    - whether the contemplated lessening is substantial.[3]

63. The first step in assessing competition is to look at market shares. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. In determining market shares, the Commission will take into account the existing participants (including ‘near entrants’), inter-firm

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[3] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* (1987) 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* (1990) 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

relationships, and the level of imports. This is followed by an application of the Commission's 'safe harbours'.

64. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or
- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

65. However, market shares are insufficient in themselves to establish whether competition in a market has been lessened. Additional factors must also be considered before a conclusion is reached. The Commission considers the affect on the level of competition in terms of:

- existing competitors;
- potential competitors; and
- other competition factors such as countervailing power.

66. These factors, along with market concentration, are considered in subsequent sections for each of the relevant markets.

67. After considering the additional factors outlined above, the Commission will assess whether the merger is likely to result in a substantial lessening of competition ("SLC").

68. Section 2(1A) of the Act provides that "substantial" means "real or of substance". Substantial was considered by McGechan J in Port Nelson Ltd.[4] He observed:

> *substantially lessening competition " is taken as meaning "lessening competition in a way which is more than insubstantial or nominal". The merely ephemeral and minimal will not suffice. Inevitably, that will involve some attention to relativity; and in the end be a question of judgment on a matter of degree.*

69. The Commission considers that it is necessary to identify a real lessening of competition that is not nominal, rather than a quantifiable measure of lessening. The lessening needs to be of such a size, character and importance that it is worthy of consideration.[5] Overall, the Commission considers that substantially lessening competition concerns a real or substantial impact on a market in a way of a lessening, hindering or preventing the process of workable and effective competition.

[4] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434.
[5] *Dandy Power Equipment Pty Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888.

THE MARKET FOR THE PROVISION OF ORGANISATIONAL SERVICES AND BRANDING TO MOTELS (THE MOTEL SERVICES MARKET)

Market Concentration

70. The Commission has defined a market for the provision of organisational services and branding to motels and motor inns. The Commission intends to use the number of properties represented by each chain as a representation of market shares. Revenue figures are not used in this case as the revenue of each motel chain varies depending on the membership fees it charges and the size of its commissions. Industry participants considered property numbers a good proxy of market share. The table below reflects the estimated market shares of the combined entity and other competitors in the market based on figures provided by the Applicant and information gained in the course of the Commission's investigation.

Table 1: Market shares in the Motel Services Market

Supplier	**Property #'s**	**%**
Best Western	71	15
Pacifica	67	15
Combined	*138*	*30*
Mitchell Group	135	30
Flag Choice	46	10
AA Host	77	17
Budget Motel	60	13
Total	**456**	**100**

71. The current three firm concentration ratio is 60%. Post acquisition the three firm concentration ratio is 70%. The combined entity's market share of 30% in the motel services market falls outside the Commission's safe harbour guidelines.

72. However, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include the constraint provided by existing or potential competitors as well as other competition factors such as the countervailing power of buyers and suppliers. These are considered for the relevant market in subsequent sections.

Existing Competition

73. Post acquisition, the Applicant will be the second largest provider of services to motels and hotels. The merged entity will continue to face competition from existing competitors, namely: Flag Choice, Mitchell Group, AA and Budget.

74. Motel chains compete with each other to provide services to motels. Motel chains compete to secure new members in desirable locations, or in locations where the motel chain is proportionately underrepresented. In order to entice new members, motel chains use sales teams who visit properties or organise promotional events for property owners to attend. All of the motel chains stated that they target properties affiliated with competitors when they are particularly desirable. [ ].

75. In addition, some properties belong to more than one brand. Although the motel chains stated this practise is often discouraged, there was generally nothing to prevent motels from co-branding subject to the economic viability of paying more than one set of subscription fees. [ ]. The rationale behind co-branding is to take advantage of the comparative strengths of competing chains. For example, AA, Mainstay and Best Western are comparatively strong in securing domestic tourists, whereas Pacifica, Budget and Flag Choice have strong relationships with international wholesalers.

76. The nature of the services provided by the motel chains suggests there are unlikely to be any capacity limits on the number of motels they can service, and that there would be no restrictions on a chain accepting new motels subject to their compliance with the standards of the chain. Although it might be considered that a chain would be reluctant to be affiliated with a large number of properties in the same region, market participants considered it an advantage to have a large presence in regions, and even to be affiliated with neighbouring properties, in order to be able to efficiently deal with excess capacity during peak demand.

77. Switching between motel chains occurs principally when a property is sold. This is due in part to some participants, [ ], requiring new property owners to sign new affiliation agreements with associated joining costs, and also due to new owners reconsidering the properties' previous relationship with a chain. Pacifica stated that approximately [ ] properties affiliated to it changed ownership annually and this often entailed a change in brand. Other participants did not consider that the incidence of switching was particularly high: [ ].

78. The ease of switching varies greatly depending on the chain to which a property is affiliated. Table 2 below outlines the exit fees incurrent by a motel leaving one of the motel chains in the market before to the end of its contractual arrangement with that chain.

Table 2: Exit Fees for Motels affiliated with Motel Chains.

Chain	**Exit Cost**
Best Western	[ ]

Pacifica	[ ]
Flag Choice	[ ]
AA	[ ]
Mitchell Group	[ ]
Budget	[ ]

79. An additional cost likely to be incurred by an accommodation provider when switching is the cost of changing signage. Budget estimated this would cost approximately [ ], while other motel chains suggested it may cost up to [ ] for the largest properties.

80. Generally, the agreement between an accommodation provider and a motel chain is for one or two years. Thus, in the event of a price increase or a reduction in quality by a motel chain an accommodation provider would be able to exit its agreement with a motel chain within one or two years without incurring exit costs in addition to the costs of replacing signage. The Commission considers that the relatively low costs of replacing signage do not constitute a barrier to switching in this instance.

81. Best Western is also a member of the Fly-Buys scheme. The scheme is used as a marketing tool targeted at domestic customers. Best Western stated that [ ] of its wholesale business comes through the Fly-Buys scheme. Market participants were not concerned that Pacifica may become part of the Fly-Buys scheme. AA stated that they considered the AA Points scheme to be an effective competitor with the Fly-Buys scheme, and Flag Choice utilised the Qantas Frequent Flyer Points scheme. Participants considered that the choice of any scheme was a business decision made by individual parties in order to open new customer channels and that it did not disadvantage any market participants.

82. Post acquisition, The Mitchell Group will be the largest competitor in the market, and will provide a significant constraint on the activities of the combined entity. Other competitors will also provide significant competition with their ability to provide services to the market.

83. Generally, there were no concerns with the acquisition and market participants considered that substantial competition would remain in the market and properties would continue to have a viable choice between competing chains.

Conclusion on Existing Competition

84. The Commission considers that the combined entity will continue to face strong competition from existing competitors, and that individual properties will continue to have a competitive choice when joining a chain. These factors will ensure significant competition exists for the combined entity post acquisition.

85. In light of the aggregation within this market falling only marginally outside of the Commission's safe harbours, the level of constraint provided by existing competitors, it is not necessary to address potential entry into the motel services market, nor is it necessary to assess the potential for the exercise of co-ordinated market power.

Conclusion on SLC in the Motel Services Market

86. In the market for the provision of organisational services and branding to motels, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, as there will be sufficient competition provided by existing competitors.

THE MARKET FOR THE PROVISION OF MOTEL ROOMS TO INTERMEDIARIES IN THE WHOLESALE MARKET (THE WHOLESALE SERVICES MARKET)

Market Concentration

87. The Commission has defined a market for the provision of motel rooms to intermediaries in the wholesale market. As in the motel services market, the Commission intends to use the number of properties represented by each chain as a representation of market shares. Thus, Table 1 above gives the market shares in this market.

88. As above, the current three firm concentration ratio is 60%. Post acquisition the three firm concentration ratio is 70%. The combined entity's market share of 30% in the motel services market falls outside the Commission's safe harbour guidelines.

89. However, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include the constraint provided by existing or potential competitors as well as other competition factors such as the countervailing power of buyers and suppliers. These are considered for the relevant market in subsequent sections.

Existing Competition

90. Motel chains compete with each other to appear in the publications prepared by wholesalers in order to source customers for their respective member properties from international and domestic tourist markets.

91. Wholesalers spoken to by the Commission had no concerns with the proposed acquisition. Wholesalers have a range of choice between possible accommodation options and did not consider the merger of Best Western and Pacifica as impacting substantially upon their current relationships in the New Zealand accommodation sector.

92. Typically, a wholesaler will have an existing non-exclusive relationship with the majority of the major accommodation providers in the New Zealand market and will offer accommodation on their behalf based on the wholesalers' preferences and target market. A variety of accommodation options, including competing motel chains, will appear in any one publication depending on the target market of that publication.

93. The price at which accommodation is offered to wholesalers is negotiated with the wholesaler, who will have the incentive to sell the greatest amount of accommodation through motel chains and other accommodation providers where it makes the largest commission. The wholesale rate between chains and wholesalers is re-negotiated annually. Wholesalers considered any attempt on the part of motel chains to increase

the wholesale price or to reduce the quality of its service would result in wholesalers offering other properties in their publications.

94. Although the Commission has defined the major hotel chains as being outside of the relevant market, market participants have suggested that there is a degree of cross-over competition between them and the motel chains, particularly in times of low demand when the major hotels lower their prices in order to secure business from the segment below their traditional incumbencies. The effect of this practise is to weaken the negotiating position of motel chains with respect to wholesalers in times of low demand, and therefore lessen any concerns that may exist in this market.

Conclusion on Existing Competition

95. The Commission considers that the combined entity will continue to face strong competition from existing competitors, and that wholesalers will continue to have a competitive choice when negotiating wholesale property rates. These factors will ensure significant competition exists for the combined entity post acquisition.

96. In light of the aggregation within this market falling only marginally outside of the Commission's safe harbours, the level of constraint provided by existing competitors, it is not necessary to address potential entry into the wholesale services market, nor is it necessary to assess the potential for the exercise of co-ordinated market power.

Conclusion on SLC in the Wholesale Services Market

97. In the market for the provision of motel rooms to intermediaries in the wholesale market, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, as there will be sufficient competition provided by existing competitors.

OVERALL CONCLUSION

98. The Commission has considered the probable nature and extent of competition that would exist in the following markets:

- The national market for the provision of organisational services and branding to motels (the motel services market); and
- The national market for the provision of motel rooms to intermediaries in the wholesale market (the wholesale services market).

99. The Commission considers that the appropriate counterfactual for comparison is the status quo.

100. The Commission has considered the nature and extent of the contemplated lessening. . In the motel services and the wholesale services markets, the proposed acquisition would result in the merged entity obtaining a market share which falls outside the Commission's safe harbour guidelines

101. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from the constraint posed by existing competition.

102. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the following markets:

- The national market for the provision of organisational services and branding to motels; and
- The national market for the provision of motel rooms to intermediaries in the wholesale market.

DETERMINATION ON NOTICE OF CLEARANCE

103. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by New Zealand Motel Federation Incorporated (Best Western) to acquire Pacifica Lodges & Inns Society Limited (Pacifica).

Dated this 4th day of December 2003

Denese Bates QC

Division Chair