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COMMERCE COMMISSION

Decision No. 655

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

SHELL NEW ZEALAND LIMITED

and

MOBIL OIL NEW ZEALAND LIMITED

The Commission:	Paula Rebstock Peter JM Taylor Denese Bates
Summary of Application:	The acquisition by Shell New Zealand Limited, or any of its interconnected bodies corporate, of the Aerostop Network assets of Mobil Oil New Zealand Limited.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
Date of Determination:	10 October 2008

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

Introduction

E1. The Commerce Commission (Commission) received an Application from Shell New Zealand Limited (Shell) seeking clearance for it, or any of its interconnected bodies corporate, to acquire the Aerostop Network assets of Mobil Oil New Zealand Limited (Mobil). The proposed acquisition relates only to the supply of aviation fuel to light aircraft and helicopters engaged in a range of general aviation activities including agriculture, flying schools, tourism and recreational flying. It relates to the supply of aviation fuel to general aviation customers through unattended bowser refuelling facilities (fuel pumps which are activated with customer swipe/fuel cards) at airfields and airports. Mobil's Aerostop Network comprises 48 unattended refuelling facilities at 34 airfields throughout New Zealand, which are used to supply Jet A1 and Avgas.

E2. The Commission must consider whether it can be satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in any market.

E3. To aid its analysis, the Commission compares two situations: one in which the acquisition proceeds (the factual); and one in which the acquisition does not proceed (the counterfactual). The impact of the acquisition on competition in a market is then viewed as the prospective difference in the extent of competition between these two situations.

The Relevant Markets

E4. To analyse the proposed acquisition the Commission first must define the relevant markets affected by the proposed acquisition in order to assess the likely competition effects.

E5. The Commission considers that the relevant markets for the consideration of the competition effects of this acquisition are:

- the local markets for the supply of Jet A1 to general aviation customers at Ardmore, Taupo, Whakatane and Paraparaumu; and
- the local markets for the supply of Avgas to general aviation customers at Ardmore and Taupo.

Factual and Counterfactual

E6. The factual scenario (with the acquisition) would remove the existing competition posed by Mobil. There would be a reduction in the number of suppliers from two to one in the Paraparaumu Jet A1 market and from three to two in the other five local markets. The markets would be reduced to a duopoly or, in the case of Paraparaumu, a monopoly.

E7. The Commission considers, in the absence of the proposed acquisition, that there are two likely counterfactuals:

- Mobil exits all local markets for the supply of Jet A1 or Avgas to general aviation customers, closing all of its Aerostop network; or
- in exiting all local markets for the supply of Jet A1 or Avgas to general aviation customers, Mobil seeks to extract the maximum value it can be selling to Shell those Aerostop facilities where there is no aggregation,

selling off those Aerostop facilities it can to third parties, and closing only those Aerostop facilities that cannot be otherwise sold.

E8. Accepting that Mobil is determined to exit all local markets for the supply of Jet A1 or Avgas to general aviation customers, the Commission has considered which of Mobil's Aerostop facilities in the six relevant markets—on a commercial and pragmatic assessment—Mobil could sell to third parties, and whether there are any local markets for which closure of the Aerostop facilities is the only option. The Commission considers that the likely counterfactual scenario for Mobil's Paraparaumu Jet A1 Aerostop facilities would be different to that of Mobil's other Aerostop facilities. The Commission concludes that the following counterfactual scenarios for each of the six relevant markets are likely:

- the only counterfactual in relation to Mobil's Jet A1 and Avgas Aerostop facilities at Ardmore is closure;
- the only counterfactual in relation to Mobil's Jet A1 and Avgas Aerostop facilities at Taupo is closure;
- the only counterfactual in relation to Mobil's Jet A1 Aerostop facility at Whakatane is closure; and
- in relation to Mobil's unattended Jet A1 Aerostop facility at Paraparaumu there is a real and substantial prospect that:
  - it may close; or
  - it may be sold to BP.

Competition Analysis

E9. In those local markets (at Ardmore, Taupo and Whakatane) where the only real and substantial prospect is that Mobil would be likely to close down its Aerostop facilities, there is no material difference in competitive constraint between the factual and counterfactual scenarios. As a consequence the Commission concludes, in respect of these five markets, that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition.

E10. In respect of Mobil's Jet A1 Aerostop facilities at Paraparaumu, the Commission considers that sale to BP is a real and substantial prospect. Accordingly, the Commission adopted this outcome as the likely counterfactual for its competition analysis. In comparing the amount of competition expected in the supply of Jet A1 at Paraparaumu in the factual with that expected in the counterfactual, the main competition factors bearing on the Commission's decision are:

- the merged entity would face no constraint from existing competition in the factual scenario, compared to the competitive constraint that it would continue to face in the second counterfactual where Mobil's Jet A1 facilities at Paraparaumu are sold to BP; and
- the merged entity would face sufficient constraint from potential competition in the supply of Jet A1 to general aviation customers at Paraparaumu, in the form of de novo entry.

E11. Against this background, the Commission considers that the scope for the exercise of unilateral market power in the supply of Jet A1 to general aviation customers at Paraparaumu is not likely to be enhanced by the proposed acquisition, relative to the counterfactuals. Therefore, the Commission is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in the local market for the supply of Jet A1 at Paraparaumu.

Conclusion

E12. The Commission is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in any of the relevant markets. The Commission gives clearance for the proposed acquisition.

THE PROPOSAL

1. A notice pursuant to s 66(1)of the Commerce Act 1986 (the Act) was registered on 23 June 2008. The notice sought clearance for the acquisition by Shell New Zealand Limited (Shell) or any of its interconnected bodies corporate, to acquire the Aerostop Network assets of Mobil Oil New Zealand Limited (Mobil).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Extensions of time were agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 8 September 2008.

3. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.[1]

STATUTORY FRAMEWORK

4. Under s 66 of the Act, the Commission is required to consider whether the proposal will not have, or would not be likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal would not be likely to substantially lessen competition then it is required to grant clearance to the application. Conversely, if the Commission is not satisfied it must decline the application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

5. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held:

> We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.[3]

6. In determining whether there is a change along the spectrum which is significant, the Commission must identify a real lessening of competition that is more than nominal and not minimal.[4] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

7. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial,

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines, January 2004*.
[2] *Commerce Commission v Woolworths & Ors* (2008) NZCA 276.
[3] *Air New Zealand & Qantas Airways Limited v Commerce Commission* (2004) 11 TCLR 347, Para 42.
[4] *Fisher & Paykel Limited v Commerce Commission* (1990) 2 NZLR 731, 758; *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 562-563 and also *Commerce Commission v Woolworths & Ors* (2008) NZCA 276.

the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.

8. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate in any given case.

THE PARTIES

Shell

9. Shell New Zealand Limited is part of the Royal Dutch Shell group of companies. The aviation business activities of Shell include the distribution to, and sale of fuel at, 32 swipe card bowser facilities (12 Aviation Jet Fuel (Jet A1) facilities and 20 Aviation Gasoline (Avgas) facilities) at 23 airfields across New Zealand. Shell has both Jet A1 and Avgas facilities at only eight locations.

Mobil

10. Mobil Oil New Zealand Limited is part of the ExxonMobil group of companies. The aviation business activities of Mobil include the distribution to, and sale of fuel at, 48 Aerostop facilities at 34 airfields nationally. Mobil has both Jet A1 and Avgas facilities at only 12 locations. At Ardmore it has multiple Avgas facilities.

OTHER PARTIES

BP

11. BP Oil New Zealand Limited (BP) is ultimately owned by BP p.l.c. The aviation business activities of BP include the distribution to, and sale of fuel at, 61 swipe card bowser facilities at 41 airfields throughout New Zealand. BP has both Jet A1 and Avgas facilities at 20 locations.

Kauriland

12. Kauriland Aviation Limited (Kauriland) is a wholly-owned subsidiary of a privately-held company, Kauriland Group Limited. Kauriland supplies Jet A1 and Avgas to general aviation customers throughout New Zealand.

13. A large portion [ ] of Kauriland's sales are to private fuel facilities of 'homebase' customers.[5] Kauriland supplies these facilities by purchasing fuel in bulk from Mobil's storage terminals. Mobil's bulk sales to Kauriland are outside the proposed acquisition and will continue - whether or not the proposed acquisition goes ahead.

14. In addition to homebase sales, Kauriland also resells fuel to the same customers at a number of airfields (when they are away from their homebase and need to refuel). Kauriland does this primarily by providing customers with Mobil and Shell cards (issued to Kauriland) and then re-bills customers for their fuel

[5] Homebase customers are customers who purchase small volumes of Jet A1 and/or Avgas for their own small fuel facility located on privately-owned land such as a farm or a private airstrip.

purchases.[6] But, it also has its own unattended refuelling facilities at two small airfields where neither Mobil or Shell have facilities.[7]

BACKGROUND

Scope of the Acquisition

15. Shell seeks clearance to acquire the Aerostop Network assets of Mobil. Mobil's Aerostop Network comprises 48 unattended refuelling facilities at 34 airfields throughout New Zealand, which are used to supply Jet A1 and Avgas.

16. Shell is not seeking to acquire Mobil's entire aviation fuel business. The proposed acquisition relates only to the supply of aviation fuel to light aircraft and helicopters engaged in a range of general aviation activities including agriculture, flying schools, tourism and recreational flying. However, the acquisition does not relate to the entire general aviation sector. It relates to the supply of aviation fuel to general aviation customers through unattended bowser refuelling facilities (fuel pumps which are activated with customer swipe/fuel cards) at airfields and airports. The acquisition excludes the supply of aviation fuel to homebase customers.

17. The supply of aviation fuel to domestic and international scheduled passenger airlines is excluded from the acquisition, as is supply to the military and other aircraft that use manned into-plane refuelling services. Also excluded from the acquisition is all infrastructure pertaining to the production, bulk storage and transportation of aviation fuel. Mobil will continue to provide these services, and retain this infrastructure, whether or not the proposed acquisition goes ahead.

General Aviation Sector

18. Shell advised that total demand for aviation fuel in New Zealand is approximately 1.4 billion litres per annum. General aviation is a very small part of the overall aviation industry, demanding approximately 60 million litres annually (40 million litres of Jet A1 and around 20 million litres of Avgas).

19. Across New Zealand Shell, Mobil and BP together have unattended refuelling facilities for general aviation customers at 67 airfields. Of those locations, 63 have Avgas facilities and 44 Jet A1 facilities. A number of airfields have both fuels, but some only have one fuel type available.

20. Currently, a high proportion of the airfields have only one supplier of refuelling services for general aviation. In the North Island, 77% of airfields have just one supplier of Jet A1 fuel to general aviation customers. For Avgas, 67% of airfields in the North Island have just one supplier.

21. There are seven locations in the North Island where Shell and Mobil are both present. However, the proposed acquisition involves only four locations, being Ardmore, Taupo, Whakatane and Paraparaumu where both Shell and Mobil offer Jet A1 and/or Avgas. This is because Shell and Mobil do not presently offer both Jet A1 and Avgas at the other three locations (i.e., at Gisborne, Palmerston North and Wellington Shell currently offers Avgas but not Jet A1, while Mobil offers Jet A1 but not Avgas).

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[6] Kauriland's preferred supplier is Mobil. At those airfields where Mobil does not have a facility, customers purchase fuel via Shell.

[7] Kauriland has facilities at one location in the North Island (Piriaka) and a second in the South Island.

22. While Shell, Mobil and BP all supply Jet A1 to general aviation customers at Taupo, only Shell has a Jet A1 tank at the airport. Both Mobil and BP source Jet A1 from Shell's tank in order to supply customers. In all other cases, the current competition occurs by the parties each having their own tank and pump facilities.

Capital Expenditure / Reinvestment in Facilities

23. In the time since the existing general aviation fuel facilities were first installed, environmental considerations have gained in prominence. In late 2006, the Environmental Risk Management Authority (ERMA) issued a Code of Practice for the Management of Existing Stationary Container Systems up to 60,000 Litres Capacity (the Code) pursuant to the Hazardous Substances and New Organisms Act 1996. All new underground stationary tanks must be designed, constructed and installed in accordance with the Code.

24. Shell advises that suppliers face major capital expenditure in the short to medium term to replace or maintain assets which are coming to the end of their asset lives (of approximately 30 years). Old underground storage tanks need to be changed to new, fully protected, above ground installations that are safer environmentally and are much easier to maintain.

25. Shell estimates that, due to ERMA's Code and Shell's internal compliance standards, over [ ] of reinvestment is needed across its existing general aviation network over the next [ ] years. Shell submits that this capital expenditure is not justified by the revenues and returns currently achieved. It estimates that the costs of a new single fuel facility (Jet A1 or Avgas) can be up to [ ] and up to [ ] for a dual facility (both fuels). [ ]

26. The oldest of Mobil's underground tanks at the four locations where both Shell and Mobil offer Jet A1 and/or Avgas is [ ] years. [ ]

27. [ ] advised that there are significant and material costs and risks in running an aviation refuelling business which requires ongoing injection of capital, rigour and the maintenance of safety standards, CAA compliance and fuel quality. This service has to be supported by the income stream the business generates which ultimately has to justify the ongoing costs, maintenance, allocation of capital and resources to sustain the business.

Economics of General Aviation

28. Shell considers that Shell and Mobil both lack the size, economies of scale and geographic coverage to compete effectively with BP. Shell submits that both Shell and Mobil are operating at sub-optimal levels. In 2007, Shell's net profit after tax from its New Zealand general aviation business was $[ ]. Mobil made a net [ ].

29. Volumes in general aviation are low compared to other segments of the aviation fuels industry and to petrol volumes at retail service station outlets. A large retail service station (e.g., [ ]) has throughput of around [ ] litres per annum. In comparison, the total volume of aviation fuel (Jet A1 and Avgas) sold by three suppliers at Ardmore is around [ ] litres per annum. Most general aviation sites are much smaller than Ardmore. For example, total volumes at Paraparaumu (for Jet A1 and Avgas) are around [ ] litres per annum. Total annual volumes in general aviation nationally (for bulk sales and airfield sales) are approximately equal to the volumes through [ ] large retail service stations.

30. In addition, Shell considers that both product markets are mature. The demand for Jet A1 is steady, but demand for Avgas is declining at an average rate of around [ ]% per annum as piston engine planes are being converted to Jet A1 or replaced by aircraft that use Jet A1.

31. Shell submits that there are, in the current environment of significant costs and historically low returns, limited incentives for re-investment in existing sites, let alone expansion, of Shell's general aviation network. In the general aviation business there is also significant exposure to environmental risks and increasing compliance costs. Shell and Mobil both submit that at present the economics of the markets do not justify continued investment. [ ]

32. Shell cited international trends to consolidation within the aviation industry in the current global economic environment. For example:

- Shell Aviation announced its withdrawal from the South West Pacific in 2006, has recently divested its network in the Caribbean islands, and [ ];
- Air BP has publicly announced its withdrawal from 22 countries; and
- Exxon Mobil exited the Polish retail fuel market in 2005, and in April 2008 announced its withdrawal from Brazil.

MARKET DEFINITION

33. 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.'[8]

34. For the purpose of competition analysis, the internationally accepted approach is to assume the 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, would be able to impose at least a small yet significant and non-transitory increase in price (a SSNIP), assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

35. The greater the extent to which one good or service is substitutable for another, on either the demand side or supply side, the greater the likelihood that they are bought and supplied in the same market.

36. 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.

37. 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 to their relative prices.

38. Jet A1 and Avgas are specialist aviation fuels. Jet A1 is a kerosene grade fuel used in turbine engine aircraft. Avgas is a motor spirit based fuel used for light

[8] s 3(1A) of the Commerce Act 1986.

piston engine aircraft. Avgas is only used by small aircraft. The two fuels are not substitutes for each other on the demand side.

39. On the supply side, the two types of aviation fuel are required to be stored and transported separately. At any given airfield, separate tank and pump facilities are required for Jet A1 and Avgas.

40. The Commission concludes that for the purpose of assessing the competitive effect of the proposed acquisition there are separate product markets for Jet A1 and Avgas. This is consistent with Shell's submissions.

Functional Markets

41. As noted above, the Application relates only to the supply of aviation fuel to light aircraft and helicopters. It does not impact on the production, importation, storage and transportation of aviation fuel. Shell further submits that the proposed acquisition has no impact on any wholesale level of the markets, where, for example, resellers acquire aviation fuel from Mobil.

42. Accordingly, the Commission considers that the appropriate functional dimension of the market is the retail supply of Jet A1 and Avgas through a supplier's airfield fuelling facility.

43. The resale of a supplier's fuel by Kauriland is not considered to be within the same functional dimension of the market. In the relevant geographic markets for the proposed acquisition, Kauriland merely supplies customers with Mobil and Shell cards which they use to purchase fuel. Kauriland is billed by the fuel company and then re-bills customers for their fuel purchases. As a result, its prices are driven by the price at which it can buy fuel from other suppliers. Kauriland does not own unattended refuelling facilities at any of the affected airfields. While Mobil and BP do not have their own Jet A1 fuel tanks at Taupo, they are not resellers. Instead they merely borrow fuel from Shell[9], which is supplied through their own fuel pumps at the airport and independently set the prices at which they sell Jet A1 at Taupo.

Geographic Markets

44. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

45. Nationally, there are three suppliers of aviation fuel: Shell, Mobil and BP. On the supply-side, the network nature of the businesses means that economies of scale and scope are likely present in the supply of aviation fuels to multiple geographically dispersed unattended refuelling facilities. On its own, this could imply national markets for the supply of aviation fuels.

46. However, on the demand-side, there is limited scope for substitutability between local airfields. Typically, a pilot would wish to re-fuel prior to take-off. En route, a pilot may have a choice of locations at which to land and re-fuel, depending upon a range of factors including the flight plan, the weather, load (including cargo and passengers), altitude and fuel capacity. This permits some small degree of choice between airfield and re-fuelling locations. The nature of the general aviation activity does mean that a number of customers fly out of more than one location. In general, however, customers based at a particular

[9] Through borrow and loan arrangements described at paragraph 7.1(c) of Shell's application.

airfield will acquire at least their initial fuel load at that airfield and would be unlikely to view other airfields as immediately substitutable.

47. Based on the above, Shell has submitted that local geographic markets are appropriate for the consideration of its application, although Shell also submits that is not appropriate for the Commission to limit its analysis to the affected local markets and ignore the network effects of the relevant product markets. Shell submits that economies of scale and geographic coverage are needed in order to make the supply of aviation fuel economic. Mobil agrees the markets may, from a competition law perspective, best be defined as local to each Aerostop and submits that [ ]

48. The Commission agrees that it would not be appropriate to focus solely on the affected local markets (where aggregation occurs) and ignore any network effects. However, the Commission considers that, in this instance, the existence of any network effects are more relevant to analysis in other areas of this report than to market definition. For example, network effects may be more relevant to an assessment of profitability of the various suppliers of aviation fuel and how this may change as they alter the number of locations at which they have unattended refuelling facilities, how this bears on decisions regarding exiting markets or reinvestment, or its relevance when considering the likelihood of entry by new competitors at only a small number of locations. In this instance, the Commission is of the view that the competitive effects of the proposed acquisition are best assessed in the context of a market that includes all those suppliers and all those buyers between whom there is close competition.

49. The Commission therefore considers that, for the purposes of considering the proposed acquisition, the relevant geographic markets are local as the demand-side factors outlined above are particularly important in the context of the proposed acquisition.

Customer Dimension

50. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission considers whether it would be appropriate to define additional markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas that are captive to those products and unable to switch in the face of a price increase.

51. Shell submits that there are four distinct customer dimensions to the markets: big jet[10], domestic/special carrier[11], military and general aviation. The first three customer types require high volumes of Jet A1 fuel and are supplied through into-plane refuelling services at airports and military bases (and are not prepared to use unattended refuelling facilities). In contrast, general aviation customers largely purchase small volumes of Jet A1 or Avgas at unattended refuelling facilities (although may occasionally use into-plane refuelling services where they are only available). Differences in customer fuel requirements and the infrastructure required to services customers, suggest that there are separate product markets for the supply of Jet A1 and the supply of Avgas to the general aviation sector.

[10] Defined as wide bodied aircraft, domestic and international carriers.
[11] Defined as turbine and turboprop aircraft operated by Air New Zealand Domestic, Air New Zealand Link, Pacific Blue and Jetstar.

52. The Commission agrees with Shell's submissions and considers that, for the purposes of considering the proposed acquisition, a customer dimension of the market is appropriate. That customer dimension is general aviation.

Conclusion on Market Definition

53. Shell submits that the relevant markets are separate local markets for the supply of Jet A1 and Avgas to general aviation customers. The Commission agrees with Shell.

54. Given the aggregation of market concentration that would arise from the proposed acquisition, the Commission concludes that the relevant markets are:

- the local markets for the supply of Jet A1 to general aviation customers at Ardmore, Taupo, Whakatane and Paraparaumu; and
- the local markets for the supply of Avgas to general aviation customers at Ardmore and Taupo.

COUNTERFACTUAL AND FACTUAL

55. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission compares the likely outcomes in two hypothetical situations, one with the acquisition (the factual) and one without (the counterfactual).[12] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition. The Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s).

Factual

56. In the factual, Shell would acquire Mobil's Aerostop Network assets. These would be integrated into Shell's swipe card bowser network. In the six relevant markets, the facilities of Shell and Mobil would be rationalised to eliminate any surplus assets. As a result, the merged entity would have facilities at 50 locations around New Zealand. BP would be the remaining existing competitor in all markets (other than where Shell is the sole supplier) in the factual. BP's network comprises 41 locations nationally.

57. Shell considers that the factual will provide Shell with the size, economies of scale and geographic coverage that it lacks. The factual would see reinvestment by Shell in the improvement of the combined (Shell and Mobil) network by up to [ ] over [ ] years. Shell submits that this reinvestment is unlikely to occur in the counterfactual.

58. Shell submits that the factual:

- generates economies of scale from increased volumes across the combined network, resulting in lower unit costs and synergy savings which Shell estimates at [ ];
- enhances Shell's presence in the Jet A1 markets;
- assists the business case for maintaining Shell's presence in general aviation in New Zealand, in particular enabling Shell to conduct future investment in its network; and

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[12] *Air New Zealand & Qantas Airways Limited v Commerce Commission* (2004) 11 TCLR 347, Para 42.

- would see Shell become a stronger competitor on a national scale through an enhanced network and increased economies of scale, better able to compete against BP (by far the largest player, with network and cost advantages).[13]

59. The Commission accepts that potential benefits of the factual relate to the entire of Shell's New Zealand general aviation business (the national network) not just the relevant local markets. However, in the factual the number of suppliers of Jet A1 and/or Avgas would reduce in six local markets (located at Ardmore, Taupo, Whakatane and Paraparaumu) and it is these markets where the Commission intends to focus its competition analysis. The proposed acquisition would result in one supplier of Jet A1 at Paraparaumu, the smallest of the affected markets.

60. Table 1 summarises the change in concentration that would occur in the factual at these airfields.

Table 1: Change in Concentration Levels

Location	Jet A1	Avgas
Ardmore	3 to 2	3 to 2
Taupo	3 to 2	3 to 2
Whakatane	3 to 2	No change
Paraparaumu	2 to 1	No change

Counterfactual

Introduction

61. 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]

62. Where there is more than one real and substantial counterfactual it is not a case of choosing the one that the Commission thinks has greater prospects of occurring. The Commission assesses the possibilities, discards those that have only remote prospects of occurring, and considers each of the real and substantial possibilities as counterfactuals against which the factual is to be assessed.

63. In this counterfactual section, the Commission:

    - sets out the views of relevant parties as to the likely counterfactual;
    - analyses the capital expenditure / reinvestment required to retain Mobil's Aerostop facilities at each of the relevant markets (to inform an assessment of what is a commercially pragmatic outcome in the absence of the proposed acquisition); and
    - outlines the Commission's views of the counterfactual.

64. Having determined the counterfactual, the Commission then goes on to compare the competition that would exist in the factual against the competition that would exist in the counterfactual.

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[13] Nationally, BP supplies [ ] of the fuel acquired by general aviation customers from unattended refuelling facilities at local and regional airfields (i.e., excluding bulk sales). Nationally, Shell supplies [ ], and Mobil the remaining [ ].

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

Shell's View of the Counterfactual

65. Shell identified four possible counterfactual scenarios:

- a continuation of the status quo;
- [ ];
- a sale of the Mobil network to an alternative purchaser; and
- Mobil's exit from the relevant markets.

66. Of the four possible counterfactuals it identified, Shell considers—in the absence of the proposed acquisition—that the likely counterfactual scenario is that Mobil would exit the general aviation sector in New Zealand. Shell considers the three national supplier model is an unsustainable market structure, so the factual scenario simply affects the timing of the change in market structure while enabling major efficiency gains and creating a strong number two player. Shell believes that, like itself, Mobil has sub-optimal scale and faces significant network upgrade costs which are not justifiable based on expected returns. Shell submits that there are no alternative purchasers who could be regarded as likely to acquire Mobil's assets. Accordingly, it submits that the likely counterfactual is that Mobil will close its existing sites, remove the equipment and exit the market.

67. Shell submits that any counterfactual would be a worse outcome for competition than the factual, as the market would lose the network benefits from the sale to Shell. In addition:

- BP's market power would be enhanced. If clearance is declined, BP might look to "cherry pick" by acquiring facilities at locations where it is not currently present or look to expand aggressively and would in any event benefit from additional volumes at sites where it is already present;
- [ ] The reinvestment that Shell has earmarked for the combined network under the proposal would not be made;
- under an "alternative purchaser" counterfactual scenario, the number three player would be likely to decline and might ultimately be forced to exit; and
- sites would close under the counterfactual that would remain open under the factual i.e., there would be harm outside the areas of overlap in the factual.

68. Shell considers that no counterfactual scenario offers a better outcome than the proposed acquisition, which is clearly efficiency-enhancing and pro-competitive.

69. [ ]

<u>Shell in the Counterfactual</u>

70. [ ]

71. [ ]

<u>Kauriland as Alternative Purchaser of Mobil Aerostop Network</u>

72. Shell submits that the only conceivable purchaser of Mobil's Aerostop Network in the counterfactual is Kauriland. However, Shell considers an acquisition by Kauriland to be unlikely given the nature of the assets, the risks inherent in the business, and the returns compared to the capital investment required. It believes that Kauriland is unlikely to be interested in acquiring Mobil's Aerostop Network in the absence of the proposed acquisition.

73. Even though Shell does not regard an acquisition by Kauriland as a likely scenario, it has assessed how that scenario would be likely to play out. In short, Shell believes that the market dynamics would, in this scenario, change quite radically from what they are now, to the detriment of competition in the general aviation sector. Shell believes that this counterfactual scenario [ ]

74. [ ] In particular, this is because:

- Kauriland is not a major oil industry player. It would be getting into a business where the risks are high, the returns historically low and substantial capital investment will be required over the medium term;
- Shell doubts Kauriland could offer Mobil a "clean break" in respect of environmental liabilities, which was a key factor for Mobil in the negotiations with Shell;
- Kauriland would face supply chain vulnerability, particularly for Avgas. It would need a Supply and Technical Services Agreement with an oil industry company and would therefore be at a cost disadvantage to an integrated producer, as Mobil is currently;
- Kauriland would face compliance, maintenance, replacement and quality control costs in the knowledge that a major incident (involving closing tanks and/or recalling product) could cause serious financial hardship to its business; and
- although Kauriland has previously acquired some assets from Mobil, those were assets associated with homebase customers. Typically homebase sites are used by a single customer, who has a vested interest in keeping the assets maintained. In contrast, Aerostop sites are unattended swipe card bowsers at sometimes remote locations. They are larger facilities (at least twice the size), used by multiple customers and must be maintained by the supplier as the ramifications of a failure to do so are very significant.

75. Shell considers that concerns over profitability, required capital investment, a desire to reduce potential liabilities, supply chain vulnerability and potentially lower margins would lead to Kauriland:

- rationalising the former Mobil network by immediately closing low contribution sites; and
- focusing efforts on Jet A1, converting some Avgas locations to Jet A1 and ultimately exiting from the supply of Avgas, most likely over a two to three year period.

<u>Part Sale / Part Closure of Mobil Network</u>

76. The Applicant submits (in its application) that it expects the Mobil would, in the counterfactual, try to realise some value by selling those assets it could to another player.

77. In the counterfactual, Shell considers it could, without raising competition issues, purchase part of Mobil's Aerostop Network - excluding the Aerostop facilities in the six relevant markets. However, [ ]

78. Shell considers that Mobil may also be able to realise some value from some of the assets in the six relevant markets.

79. BP is not present in the market for the supply of Jet A1 at Paraparaumu. As to the prospect of BP acquiring Mobil's Paraparaumu assets in the counterfactual, Shell submits that [ ]

80. As to the prospect of Kauriland acquiring some or all of Mobil's Aerostop facilities in the six relevant markets in the counterfactual, Shell [ ]

Mobil's View of the Counterfactual

81. [ ]

82. [ ]

83. [ ]

84. [ ]

85. [ ]

86. [ ]

Kauriland's View of the Counterfactual

87. In 2005, Kauriland expanded the scope of its business to include the distribution of aviation fuel (in addition to its transportation business). About the same time, [ ]

88. Kauriland has since installed two of its own swipe-card airfield facilities (one in the North Island and one in the South Island), but only where there is demand and to fill in the gaps in the networks of Mobil and Shell. [ ]

89. Table 2 summarises, for each of the six affected markets, Kauriland's interest in acquiring Mobil's assets in the counterfactual.

Table 2: Kauriland's Interest in Mobil Sites

Facility	Interested?	Reasons
Ardmore Jet A1	[ ]	▪ [ ] ▪ [ ] ▪ [ ]
Ardmore Flying School Avgas	[ ]	▪ [ ] ▪ [ ] ▪ [ ]
Ardmore Second Avgas Facility	[ ]	▪ [ ] ▪ [ ]
Taupo Jet A1	[ ]	▪ [ ] ▪ [ ] ▪ [ ] ▪ [ ]
Taupo Avgas	[ ]	▪ [ ] ▪ [ ]
Whakatane Jet A1	[ ]	▪ [ ] ▪ [ ]
Paraparaumu Jet A1	[ ]	▪ [ ]

90. [ ]

91. [ ]

92. [ ]

93. [ ]

BP's View of the Counterfactual

94. As noted later under potential competition, [ ]

95. [ ]

96. [ ]

- [ ]
- [ ]
- [ ]
- [ ]
- [ ]

97. [ ]

98. [ ]

The Commission's View of the Counterfactual

99. The Commission now considers the likely characteristics of the counterfactual below. Key to assessment of the counterfactual is whether Mobil would remain in the relevant markets or, if Mobil is determined to exit, whether an alternative purchaser might be found. For this reason, the Commission has firstly examined the economics and the capital expenditure / reinvestment required to retain Mobil's Aerostop at each of the relevant markets. The Commission then goes on to consider the likelihood of the possible counterfactual scenarios suggested by the Applicant, Shell.

<u>Capital Expenditure / Reinvestment in Facilities</u>

100. Table 3 summarises the total revenues for the three suppliers for each of the relevant markets, based on data for the 2007 calendar year. It shows that Ardmore and Taupo are the largest of the relevant markets.

Table 3: Market Revenues

Location	Jet A1	Avgas
Ardmore	[ ]	[ ]
Taupo	[ ]	[ ]
Whakatane	[ ]	
Paraparaumu	[ ]	

101. The capital expenditure required at each of Ardmore, Taupo, Whakatane and Paraparaumu in the next two years is set out below. The Commission notes that the estimates provided by Shell, Mobil and BP include only the costs of demolishing and removing underground tanks, and the cost of installing new above ground tanks, and exclude any potential remediation of sites due to leakage.

102. The Commission has estimated the payback period on the reinvestment needed in the various suppliers' unattended refuelling assets in each of the six affected markets. To estimate the payback periods, the capital expenditure figures for

each facility were divided by an estimate of the margin earned at that facility. The margin (in dollars) for each facility was calculated by multiplying volume by an average national margin (in cents per litre), the margin being an average of all three suppliers. In the case of Mobil, the Commission tested the sensitivity of the payback periods derived to volumes, by also calculating the payback periods based on Shell and BP's [ ] volumes in those same markets.

Ardmore

103. [ ] Table 4 summarises the capital expenditure required at Ardmore for each of the three suppliers over the next two years.

Table 4: Ardmore Capex

	Capex	Notes
Supplier	**$**	
Shell	[ ]	[ ]
Mobil	[ ]	[ ]
BP	[ ]	[ ]
Total	**[ ]**	

104. [ ]

105. [ ] Shell's Jet A1 revenue at Ardmore was $[ ] in 2007. [ ].

106. While Mobil's Avgas facility at Ardmore Flying School generates annual revenue of $[ ], its other Avgas and Jet A1 facility combined only generate annual revenue of $[ ]. Mobil has advised that [ ]

107. As noted in Table 5, Mobil's payback period on reinvestment, based on existing volumes, is [ ]

Table 5: Ardmore Payback Periods

Facility	Mobil Capex ($)	Payback Period (Years)	Payback Range (Shell and BP Vol)
Jet A1	[ ]	[ ]	[ ]
Avgas	[ ]	[ ]	[ ]
Flying School	[ ]	[ ]	

108. [ ]

109. [ ]

110. [ ] Reinvestment required to retain Mobil's Aerostop is not likely to be economic for Mobil in the event that the proposed acquisition does not go ahead, except possibly in respect of the Ardmore Flying School Avgas facility. [ ][15]

Taupo

[15] [ ]

111. As already noted, only Shell has a Jet A1 tank at the airport. [ ] All three suppliers have Avgas facilities at Taupo. Table 6 highlights capital expenditure in the next two years for each supplier at Taupo, [ ]

Table 6: Taupo Capex

	Capex	Notes
Supplier	**$**	
Shell	[ ]	[ ]
Mobil	[ ]	[ ]
BP	[ ]	[ ]
Total	**[ ]**	

112. [ ].

113. Mobil's payback period on reinvestment, based on existing volumes, is [ ]

114. Reinvestment at Taupo required to retain Mobil's Aerostop is not likely to be economic for Mobil in the absence of the proposed acquisition.

Whakatane

115. Table 7 outlines anticipated capital expenditure in the next two years for each supplier at Whakatane. As Table 7 highlights, [ ]

Table 7: Whakatane Capex

	Capex	Notes
Supplier	**$**	
Shell	[ ]	[ ]
Mobil	[ ]	[ ]
BP	[ ]	[ ]
Total	**[ ]**	

116. [ ] Reinvestment required to retain Mobil's Aerostop at Whakatane is likely to be economic for Mobil in the absence of the proposed acquisition.

Paraparaumu

117. Table 8 summarises expected capital expenditure in the next two years for each supplier at Paraparaumu. [ ] even though the proposed acquisition only impacts on the Jet A1 market at Paraparaumu.

Table 8: Paraparaumu Capex

	Capex	Notes
Supplier	**$**	
Shell	[ ]	[ ]
Mobil	[ ]	[ ]

BP	[ ]	[ ]
Total	**[ ]**	

118. [ ].

119. Mobil's payback period on reinvestment, based on existing volumes, is [ ]

120. Reinvestment required to retain Mobil’s Jet A1 Aerostop at Paraparaumu is not likely to be economic for Mobil in the absence of the proposed acquisition or an increase in Jet A1 volumes in Paraparaumu.

Summary of the Economics of Reinvestment in the Relevant Markets

121. In summary, after examining the economics and the capital expenditure / reinvestment required for Mobil to retain its Aerostop in each of the relevant markets, the Commission considers that reinvestment required in the absence of the proposed acquisition:

- at Ardmore is not likely to be economic, except possibly in respect of the Ardmore Flying School Avgas facility;
- at Taupo is not likely to be economic;
- at Whakatane is likely to be economic; and
- at Paraparaumu, in relation to Jet A1, is not likely to be economic absent an increase in Jet A1 volumes in Paraparaumu.

122. The Commission now goes on to consider the likelihood of the possible counterfactual scenarios suggested by Shell.

<u>Shell – [ ]</u>

123. [ ]

124. The Commission considers that, in terms of the relevant markets for the present competition analysis, Shell will remain as a competing supplier in the counterfactual for the next two years.

<u>Closure of Mobil Aerostop Network</u>

125. [ ]

126. To quit the Aerostop business, Mobil would face substantial costs of closure, including remediation and lease exit seeking to obtain a clean break and minimise any residual environmental liabilities that would crystallise on exit. However, the Commission’s analysis of the economics and capital expenditure / reinvestment required to retain Mobil’s Aerostop at each of the relevant markets indicates that—except for Whakatane—the payback period on the reinvestment needed is unlikely to justify the cost of continuing to operate the network.

127. There is also evidence of Mobil closing sites that are uneconomic. Mobil is in the process of closing its Aerostop facility at Milford Sound. [ ] The site is being closed notwithstanding complaints from customers. [ ]

128. Mobil is contractually obliged to [ ]

129. In summary, the Commission accepts that Mobil has determined to exit the general aviation market (quit the Aerostop business) and there is a real and substantial prospect that Mobil’s Aerostop Network would simply close. However, for reasons explained below, the Commission considers that Mobil

may also try to realise some value by selling some of the Aerostop business assets to another player.

Sale of Mobil Aerostop Network

130. The Commission considers that the only conceivable purchaser of Mobil's entire Aerostop Network in the counterfactual is Kauriland. It could not identify any other alternative purchaser of Mobil's Aerostop Network.

131. [ ] Accordingly, in the Commission's view, the sale of Mobil's network to an alternative purchaser is not likely in the absence of the proposed acquisition.

Part Sale / Part Closure of Mobil Network

132. The Commission accepts that Mobil wants to exit the market. However, it is not necessarily economically rational for Mobil to simply shut down the entire Aerostop Network in the counterfactual. The Commission considers that it may be rational for Mobil to seek to extract the maximum value it can by selling off those sites it can to third parties, (for example, BP or Kauriland) and closing down only those sites that cannot be sold.

Sale of Partial Network to Shell

133. [ ]

134. In this context, the Commission analysed the volumes of Avgas and Jet A1 that go through the six relevant markets, to better understand the likely effect on economies of scale and benefits that may flow from an acquisition that excluded those sites. New Zealand-wide, the factual would increase Shell's Jet A1 volumes by [ ]% and Avgas volumes by [ ]%. The increase in Shell's national volumes that come from the six relevant markets would be [ ]% for Jet A1 and [ ]% for Avgas. The Commission considers that, as a proportion of the overall gains that Shell might obtain from acquiring Mobil's Aerostop assets, the volumes from the six relevant markets are not determinative. The majority of the increase in Shell's volumes is instead derived from the markets where there is no increase in concentration in the factual.

135. Even if the acquisition excluded the assets of the six relevant markets, Shell would still be likely to have the opportunity to:

- generate economies of scale from increased volumes across the combined network, resulting in lower unit costs and synergy savings;
- enhance its presence in the Jet A1 markets;
- assist its business case for maintaining a presence in general aviation in New Zealand, in particular by enabling Shell to conduct future investment in its network; and
- become a stronger competitor on a national scale through an enhanced network and increased economies of scale, and, therefore, be better able to compete against BP.

136. The Commission considers it unlikely that Shell would refuse to proceed with a partial acquisition. In the absence of the proposed acquisition, it is likely that Mobil could realise some value by selling to Shell the Aerostop assets at those sites where there is no increase in market concentration.

Sale of Large Sites to Kauriland

137. In five of the relevant markets in the factual, the number of suppliers will be reduced from three to two (with Shell and BP remaining as competitors). The Commission has considered whether, in any of the six relevant markets, sale to Kauriland might occur in the absence of the proposed acquisition.

138. The Commission considers that Kauriland is unlikely to acquire any of Mobil's facilities in the six relevant markets. [ ]

139. The Commission concludes that sale of any of the assets at the six relevant parts of the Aerostop Network to Kauriland is not likely.

Sale of Paraparaumu Jet A1 Facilities to BP

140. As BP already supplies Jet A1 to general aviation customers at Ardmore, Taupo, Whakatane, and supplies Avgas to general aviation customers at Ardmore and Taupo, an acquisition of these Aerostop assets of Mobil would give rise to market concentration and aggregation. However, the number of suppliers of Jet A1 at Paraparaumu will be reduced from two to one in the factual as this is a market where BP is not already present. The Commission has considered whether Mobil might sell its Jet A1 assets at Paraparaumu to a third party in the absence of the proposed acquisition.

141. [ ]

142. Shell, in its application, noted that there is speculation that Air New Zealand may start a Domestic / Special Carrier service at Paraparaumu, and that services may commence in January 2009. In September 2007, Air New Zealand announced that it was evaluating utilising Paraparaumu Airport for domestic services. [ ]

143. The Commission asked Air New Zealand about the likelihood that it will commence domestic air services at Paraparaumu airport within the next two years. [ ]

144. [ ]

145. In the circumstances, the Commission considers that there is a real and substantial prospect that BP would acquire Mobil's Jet A1 facilities at Paraparaumu in the absence of the proposed acquisition.

Conclusion on Counterfactual

146. The Commission considers, in the absence of the proposed acquisition, that there are two likely counterfactuals:

- Mobil exits all local markets for the supply of Jet A1 or Avgas to general aviation customers, closing all of its Aerostop network; or
- in exiting all local markets for the supply of Jet A1 or Avgas to general aviation customers, Mobil seeks to extract the maximum value it can be selling to Shell those Aerostop facilities where there is no aggregation, selling off those Aerostop facilities it can to third parties, and closing only those Aerostop facilities that cannot otherwise be sold.

147. Under either of these counterfactuals, in respect of the local markets within Mobil's Aerostop network where the proposed acquisition would cause no aggregation, there is no material difference in competitive constraint between the factual and counterfactual scenarios for each of these local markets for the

supply of Jet A1 or Avgas to general aviation customers. As a consequence, the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in any of those local markets.

148. Accepting that Mobil is determined to exit all local markets for the supply of Jet A1 or Avgas to general aviation customers, the Commission has considered which of Mobil's Aerostop facilities in the six relevant markets—on a commercial and pragmatic assessment—Mobil could sell to third parties, and whether there are any local markets for which closure of the Aerostop facilities is the only option. The Commission considers that the likely counterfactual scenario for Mobil's Paraparaumu Jet A1 Aerostop facilities would be different to that of Mobil's other Aerostop facilities. The Commission concludes that the following counterfactual scenarios for each of the six relevant markets are likely:

- the only counterfactual in relation to Mobil's Jet A1 facility at Ardmore is closure;
- the only counterfactual in relation to Mobil's Avgas facilities at Ardmore is closure;
- the only counterfactual in relation to Mobil's Jet A1 facility at Taupo is closure;
- the only counterfactual in relation to Mobil's Avgas facility at Taupo is closure;
- the only counterfactual in relation to Mobil's Jet A1 facility at Whakatane is closure; and
- in relation to Mobil's unattended Jet A1 refuelling facilities at Paraparaumu there is a real and substantial prospect that:
  - it may close; or
  - it may be sold to BP.

149. In those local markets (at Ardmore, Taupo and Whakatane) where the only real and substantial prospect is that Mobil would be likely to close down its Aerostop facilities, there is no material difference in competitive constraint between the factual and counterfactual scenarios. As a consequence the Commission concludes, in respect of these five markets, that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition. These markets are not considered further.

150. In respect of Mobil's Jet A1 Aerostop facilities at Paraparaumu, the Commission considers that sale to BP is a real and substantial prospect. Accordingly, the Commission has adopted this outcome as the likely counterfactual for the competition analysis that follows. In the counterfactual where Mobil's unattended Jet A1 refuelling facilities at Paraparaumu are sold to BP, the degree of competitive constraint faced by Shell in the factual scenario may be less than that faced in the counterfactual. The Commission now proceeds with the competition analysis of the local market for the supply of Jet A1 to general aviation customers at Paraparaumu.

COMPETITION ANALYSIS

Introduction

151. The Commission's analytical framework is to assess the impact of the merger by analysing whether the proposed acquisition would lead to a substantial lessening of competition (SLC) in the affected markets.

152. A SLC could be likely if the Commission reaches the view that in the factual, the potential for the merged entity, or other market participants, to exercise market power is enhanced when compared to the counterfactual. Acquisitions that increase concentration in markets enhance the potential for market power to be exercised in two main ways:

- by reducing competition constraints that lead to an increase in market power of the remaining firms acting independently (non-coordinated, or unilateral, effects); and/or
- by changing the nature of competition in a way that makes tacit or express coordination between firms more likely, effective and stable (coordinated effects).

153. The potential for the enhancement of a unilateral or a co-ordinated exercise of market power, is assessed in terms of:

- existing competition;
- potential competition; and
- other competition factors, such as the countervailing market power of buyers or suppliers.

154. In summary, the competition analysis carried out by the Commission assesses whether the potential for exercising unilateral or co-ordinated market power is enhanced in the factual when compared to the counterfactual by analysing existing and potential competition and other possible competitive constraints.

Unilateral Effects

155. An acquisition that significantly increases seller concentration in a market may lead to circumstances where competition between firms in the market is seriously reduced. In markets that are sufficiently concentrated, the actions of individual firms can have identifiable effects on their competitors, such that firms recognise their interdependence. The interdependence of firms may lead them to anticipate competitors' responses to their own actions and take this into account in their own decisions. The repeated nature of such decisions can have significant effects on business strategies and on competition.

156. The Commission notes that it is the creation of the potential for a business to exercise market power that is the focus of the analysis, rather than whether or not the market power would actually be exercised should it be obtained. In the circumstances here, where the merged entity faces only limited constraint from existing competition or from potential entry and where other competition factors are insufficient to nullify the market power, the Commission considers that the merged entity (and the other remaining entity in the market) would be likely to have the ability to exercise unilateral market power much more strongly, compared to the counterfactual scenario.

157. This section assesses the potential for unilateral market power to be exercised, and whether a SLC would arise in the factual when compared to any of the counterfactuals. The potential for unilateral market power to be enhanced takes into account the scope for existing and potential competition, and other potential constraints, such as countervailing power held by purchasers, as between the two scenarios.

Existing Competition

158. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

159. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

160. In the factual, Mobil's Jet A1 facility at Paraparaumu would be sold to Shell. The number of suppliers of Jet A1 general aviation customers at Paraparaumu would reduce from two to one.

161. Table 9 provides estimated market shares for Paraparaumu, based on volume.

Table 9: Paraparaumu Jet A1 Market Shares

Supplier	Volume (litres)	%
Shell	[ ]	[ ]
Mobil	[ ]	[ ]
Merged Entity	**[ ]**	**100.00%**
BP	N/F	
Total	**[ ]**	**100%**

162. As noted in Table 9, a total of [ ] million litres of aviation fuel are supplied to general aviation customers at Paraparaumu annually.

163. Currently, Shell has [ ]% of the Jet A1 market at Paraparaumu. Its Jet A1 volumes are [ ] those of Mobil. In the factual, the merged entity will have 100% market share in supply of Jet A1, absent entry. The three-firm concentration would remain at 100%. This is outside the Commission's safe harbour guidelines.

164. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers how competition occurs in the market.

165. Shell submitted (in its Application) that the proposed acquisition would only nominally reduce the number of suppliers of Jet A1 from two to one, as there is currently no throughput through the Mobil's Jet A1 facility at Paraparaumu. Shell understood that the major Jet A1 customer, Helipro, who is supplied by Kauriland, presently purchases its Jet A1 from Shell (rather than its preferred

supplier Mobil). Shell also submitted that prior to the sale to Shell being agreed, Mobil was about to remove its Jet A1 storage tanks at Paraparaumu.

166. However, the Commission's investigations have found otherwise. Jet A1 is still being sold from Mobil's facility at Paraparaumu, albeit with only small volumes [ ]

167. [ ]

168. [ ]

169. In the local market for the supply of Jet A1 to general aviation customers at Paraparaumu, no existing competitors will remain in the factual. The Commission considers that, while Mobil's volumes are low, its presence in the market nonetheless provides some competitive constraint, giving customers an alternative choice of supply. Existing competitive constraints will be diminished in the factual. The Commission considers it appropriate to go on and explore potential and other competition factors that may constrain the merged entity in this market in the factual.

Potential Competition

170. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real competitive constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any impediments they might encounter should they try. In order for market entry to be a sufficient constraint, entry must satisfy the LET test (be likely, sufficient in extent and timely).

<u>Conditions of Entry</u>

171. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of market conditions that impede entry.

172. Shell considers that the requirements for entry through the establishment of a site at a new location are the same as for reinvestment (i.e. asset replacement). Shell submits that greenfields entry at a new location requires:

- resource consent;
- site and tank certification;
- ERMA/HSNO compliance; and
- a lease, licence or less formal access rights.

173. Shell says entry is reasonably capital intensive, such that any decision to invest must take into account the likely returns on a site-by-site basis, and hence volumes at individual sites. Shell estimates that investment of up to [ ] is needed for a single fuel (Jet A1 or Avgas) facility, or up to [ ] for a dual facility (both fuels). This includes the cost of installation of tank(s), a swipe card bowser and the associated hoses and pumps. Based on its current investment criteria, Shell considers that a facility requires at least [ ] litres throughput per annum to be a viable financial proposition.

174. BP has submitted that [ ]

175. There has previously been entry into the relevant markets in the last decade, for example, BP entered Whakatane around 2000/2001 and has more recently entered Westport. Kauriland has also established facilities at one location in the North Island (Piriaka) and a second in the South Island. The Commission considers entry conditions are not such as to constitute barriers that would significantly hinder new entry in the factual scenario. Entry by existing suppliers in other customer or geographic dimensions of aviation fuels markets would be relatively easy.

<u>The "LET" Test</u>

176. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:

- Likely in commercial terms;
- Sufficient in Extent to cause market participants to react in a significant manner; and
- Timely i.e., feasible within two years from the point at which market power is first exercised.

177. Shell considers that BP has a history of expansion and new entry, including at sites that Shell would not consider viable. While BP does not currently have Jet A1 tank facilities at Paraparaumu, Shell considers that BP has a presence in Avgas at Paraparaumu and could easily establish Jet A1 facilities. Further, Shell submits that the costs of establishing a Jet A1 facility would not be prohibitive for BP and entry could be effected inside 18 months.

178. As noted previously, there is speculation that Air New Zealand may start a Domestic / Special Carrier service at Paraparaumu. Shell is of the view that, if that development were to go ahead, it would create a new opportunity to offer an into-plane Jet A1 service at Paraparaumu which could incentivise BP, Kauriland and/or Mobil to enter Paraparaumu in that customer dimension of Jet A1 markets. While Air New Zealand would never be supplied through unattended refuelling facilities (only into-plane facilities), a supplier that established into-plane Jet A1 fuel facilities at Paraparaumu to supply Air New Zealand could use those same facilities to supply general aviation customers. Shell notes that the proposed acquisition has no impact on the potential for future competition to establish such a service at Paraparaumu.

179. [ ]

180. [ ]

181. [ ]

182. [ ]

183. There is plenty of spare land at Paraparaumu Airport which could be leased by a de novo entrant for Jet A1 fuel facilities. [ ]

184. The Kapiti Coast District Council has made amendments to the district plan to allow for redevelopment of the airport. At present, Paraparaumu Airport is a non-certificated aerodrome. Paraparaumu Airport Holdings Limited is seeking certification from the Civil Aviation Authority so that aircraft with capacity for more then 30 passengers are able to undertake regular air transport operations from the airport. It anticipates having certification by the end of 2008 or early 2009.

185. In September 2007, Air New Zealand announced that it was evaluating utilising Paraparaumu Airport for domestic services. As discussed above, Air New Zealand advised the Commission that [ ]

186. The Commission considers that de novo entry into the local market for the supply of Jet A1 to general aviation customers at Paraparaumu is:

- likely in commercial terms;
- sufficient in extent to be constrain an attempt by Shell to exercise market power; and
- is feasible within two years from any attempted exercise of market power.

<u>Conclusion on Potential Competition</u>

187. The Commission concludes that in the factual the merged entity would be constrained by the threat of de novo entry. This competitive constraint alleviates the competition concerns associated with the proposed acquisition in the supply of Jet A1 to general aviation customers at Paraparaumu. Given this, the Commission has found it unnecessary in this instance to analyse the countervailing power of purchasers.

Overall Conclusion of Potential for Unilateral Effects

188. The Commission has assessed the potential for unilateral market power to be enhanced in the factual relative to the counterfactuals. Taking all of the above-discussed competition factors into account, it has reached the view that a substantial lessening of competition would not be likely to result from the proposed acquisition. The potential for the exercise of unilateral market power in the factual would be constrained by the threat of new entry.

189. It has not been necessary in this instance to analyse the potential for co-ordinated effects to arise in the factual.

OVERALL CONCLUSION

190. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the following markets:

- the local markets for the supply of Jet A1 to general aviation customers at Ardmore, Taupo, Whakatane and Paraparaumu; and
- the local markets for the supply of Avgas to general aviation customers at Ardmore and Taupo.

191. In those local markets (at Ardmore, Taupo and Whakatane) where the only real and substantial prospect is that Mobil would be likely to close down its Aerostop facilities, there is no material difference in competitive constraint between the factual and counterfactual scenarios. As a consequence the Commission concludes, in respect of these five markets, that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition.

192. In respect of Mobil's Jet A1 facilities at Paraparaumu, the Commission considers that sale to BP is a real and substantial prospect. Accordingly, the Commission adopted this outcome as the likely counterfactual for its competition analysis. In comparing the amount of competition expected in the

supply of Jet A1 at Paraparaumu in the factual with that expected in the counterfactual, the main competition factors bearing on the Commission's decision are that:

- the merged entity would face no constraint from existing competition in the factual scenario, compared to the competitive constraint that it would continue to face in the counterfactual where Mobil's Jet A1 facilities at Paraparaumu are sold to BP; and
- the merged entity would face sufficient constraint from potential competition in the supply of Jet A1 to general aviation customers at Paraparaumu, in the form of de novo entry.

193. Against this background, the Commission considers that the scope for the exercise of unilateral market power in the supply of Jet A1 to general aviation customers at Paraparaumu is not likely to be enhanced by the proposed acquisition, relative to the counterfactuals. Therefore, the Commission is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in the local market for the supply of Jet A1 at Paraparaumu.

DETERMINATION ON NOTICE OF CLEARANCE

194. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Shell, or any of its interconnected bodies corporate, to acquire the Aerostop Network assets of Mobil.

Dated this 10 October 2008

Paula Rebstock

Chair
Commerce Commission