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COMMERCE COMMISSION

Decision No. 586

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

LION NATHAN LIMITED

and

INDEPENDENT LIQUOR (NZ) LIMITED

The Commission:	Paula Rebstock David Caygill Donal Curtin
Summary of Application:	The acquisition by Lion Nathan Limited to acquire up to 100% of the shares or assets of Independent Liquor (NZ) 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:	24 August 2006

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 3 July 2006. The Notice sought clearance for the acquisition by Lion Nathan Limited (Lion, or the Applicant) to acquire up to 100% of the shares or assets of Independent Liquor (NZ) Limited (Independent).

2. In New Zealand, Lion is the main suppler of beer and spirits, while Independent is the main supplier of ready-to-drink (RTD) products. The Commission cleared the proposed acquisition primarily because of the strength of existing competitors and their ability to increase supply to the relevant markets.

3. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the national markets for the manufacture/importation and wholesale supply of:

   - RTDs (the RTD market);
   - individual spirit markets for gin, vodka, bourbon, Scotch whisky, brandy, rum, and liqueurs; and
   - beer (the beer market).

4. Independent has not announced that it is for sale but there is widespread speculation that it will be sold in the short-term. However, the Commission considers that the competition effects in the counterfactual would be similar in either scenario; whether Independent continues under its present ownership or owned by a non-industry third party.

5. In respect of the RTD market, the Commission recognises that the enhanced economies of scope resulting from the acquisition would give Lion a competitive advantage. However, this competitive advantage is not considered sufficient to amount to a barrier to expansion. The proposed acquisition would not restrict existing suppliers from utilising their established relationships with retail outlets to ensure continued access to the relevant sales channels.

6. In addition, the Commission considers that due to the ease of supply of RTDs and the ease with which existing competitors can expand their distribution networks, there is unlikely to be any significant difference in the supply of RTDs between the factual and the counterfactual scenarios.

7. Accordingly, the Commission considers that existing competition in the RTD market is likely to provide significant constraint on the combined entity, post-acquisition, due to the ease of expansion by existing competitors.

8. In respect of the spirits markets, competition is mainly between international brands and this would continue post-acquisition. Accordingly, given the strength of existing competitors and their ability to increase supply, the Commission is satisfied that there is unlikely to be a substantial lessening of competition as a result of the proposed acquisition.

9. In respect of the beer market, the Commission considers that, post-acquisition, DB would continue to be a strong competitor in the beer market. DB has an established presence in the market and it is not constrained by capacity considerations. In addition, the Commission considers that, in both the factual and counterfactual scenarios, the main competitive dynamic in the market would be between Lion and DB. Accordingly, the Commission is satisfied that DB

would provide sufficient constraint to any attempt by the combined entity to exercise market power.

10. The Commission is therefore satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the affected markets.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 3 July 2006. The Notice sought clearance for the acquisition by Lion Nathan Limited (Lion, or the Applicant) to acquire up to 100% of the shares or assets of Independent Liquor (NZ) Limited (Independent).

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. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 25 August 2006.

3. The Applicant sought confidentiality for specific 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.

4. 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

5. Under s 66 of the Act, the Commission is required to consider whether the proposal will have, or would be likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not 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 standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

6. 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 judgment 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]

7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is not minimal.[4] Competition must be lessened in a considerable and sustainable way.

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[3] *Air New Zealand & Qantas Airways Ltd v Commerce Commission,* unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.
[4] See Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

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.

8. 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, 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.

9. 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.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

    - with the acquisition in question (the factual); and
    - in the absence of the acquisition (the counterfactual).

11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:

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

KEY PARTIES

Lion Nathan Limited

12. Lion is an Australian registered company listed on the Australian and New Zealand Stock Exchanges. In New Zealand, Lion’s business activities are carried out by wholly-owned subsidiary companies, namely: New Zealand Breweries Limited; Lion Nathan Wines and Spirits New Zealand Limited; New Zealand CBC Limited; and Lion Liquor Retail Limited.

13. In New Zealand, Lion manufactures and distributes a range of alcoholic beverages, namely beer, wine, spirits and ready to drink (RTD) products. Lion’s main brands include Steinlager, Speight’s and Lion Red. It also has the New Zealand licence to supply a number of international brands including Guinness, Stella Artois, Gordon’s, Coruba and Baileys.

Independent Liquor (NZ) Limited

14. Independent is a privately owned and operated manufacturer of alcoholic beverages. Independent supplies a range of wine, beer and spirits although it is mostly widely known for its RTD products.

15. Independent has a number of manufacturing plants in both New Zealand and Australia. It recently sold its business operations in the United Kingdom [ ]

OTHER RELEVANT PARTIES

Manufacturers and Importers

DB Breweries Limited (DB)

16. DB manufactures and distributes a range of beers including Heineken, Export Gold and Tui. Also, DB recently began manufacturing a bourbon and cola RTD called Barrel 51. DB is a subsidiary of Asia Pacific Breweries Limited, which is based in Singapore.

17. DB also coordinates the 'Liquorland' franchise chain of retail liquor stores and owns the master franchise for Liquorland. DB previously managed these outlets before they were converted to franchise stores in 2000. There are approximately 80 Liquorland stores.

Foster's Group Limited (Foster's)

18. Foster's manufactures a range of alcoholic beverages and is based in Australia. It is the leading beer manufacturer in Australia and recently increased its wine portfolio with the acquisition of Southcorp Limited in 2005.

19. In New Zealand, Foster's predominately distributes a range of beverages including beer, wine and spirits. These brands include Victoria Bitter, Crown lager, Captain Morgan rum, and Skyy vodka. Foster's is also the distributor for 42 Below Limited (42 Below), a boutique spirit manufacturer.

Glengarry Hancocks Limited (Hancocks)

20. Hancocks imports, distributes and retails wine and spirits in New Zealand. Its importation and distribution business operates under the 'Hancocks' name and accounts for [ ] of its turnover. It has a total of 16 'Glengarry' retail outlets in Auckland and Wellington.

Maxxium New Zealand Limited (Maxxium)

21. Maxxium imports and distributes a range of wine and spirits in New Zealand. These brands include Jim Beam bourbon, The Famous Grouse Scotch whisky, Absolut vodka and Midori.

Diageo plc (Diageo)

22. Diageo is an international company which owns a number of wine, beer and spirits brands. These brands include Gordon's gin, Smirnoff vodka and Johnnie Walker whisky. In New Zealand, Diageo brands are primarily distributed through licencing arrangements with Lion.

Pernod Ricard S.A (Pernod Ricard)

23. Pernod Ricard is a publicly listed French company, which produces and distributes a range of wine and spirit brands. In New Zealand, Pernod Ricard's primary spirit brands included Beefeater gin, Wild Turkey bourbon and Kahlua.

Retailers

Retail liquor outlets

24. In New Zealand, alcohol has traditionally been sold in specialist retail liquor outlets, often called 'bottle stores'. These stores are also referred to as off-premise outlets. Typically, these stores operate under a franchise or a national chain and include:

- Super Liquor Holdings Limited (Super Liquor), which has approximately 100 'Super Liquor' franchise stores[5];
- Liquorland, which has approximately 80 franchise stores and is coordinated by DB;
- The Liquor Centre Group, which has approximately 130 franchise stores;
- The Mill Liquorsave Limited (The Mill), which operates a national chain of 40 stores; and
- Lion Liquor Retail Limited, which operates 40 'Liquor King' stores for Lion.

Supermarkets

25. The two main supermarket chains in New Zealand are Foodstuffs and Progressive Enterprises Limited. Since 1999, supermarkets have been selling beer and are now one of the main retail outlets for beer suppliers. Under the current legislative framework these stores are not allowed to sell spirits or RTDs.

On-premise outlets

26. The hospitality trade, such as bars and restaurants, is also a significant retail outlet for suppliers. These outlets are often referred to as on-premise outlets.

INDUSTRY BACKGROUND

27. In New Zealand, the most popular alcoholic beverage when measured by volume is beer, with wine the second most popular. Beer accounts for approximately 40% of the total amount of alcohol consumed.[6] However, industry participants advised that the demand for beer has steadily decreased in recent years, noting that the per capita consumption of beer is in decline.

28. The demand for spirits is also decreasing. Industry participants advised that drinking preferences are becoming more diverse such that the demand for 'traditional' drinks like gin or Scotch whisky has declined while wine and RTDs have become more popular. A notable exception is bourbon, which is one of the few spirits that has increased in popularity in recent times. Bourbon is now the most popular spirit in New Zealand.[7]

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[5] The Commission notes that Lion previously had a close relationship with Super Liquor and has one seat on Super Liquor's board. However, Lion currently has no equity interest in Super Liquor.

[6] Source: Beer, Wine and Spirits Council of New Zealand, www.beerwsc.co.nz .

[7] For example, see Distilled Spirits Association of New Zealand, www.distillers.co.nz .

29. Industry participants advised the Commission that the main growth area in the alcoholic industry has been in RTD products. Essentially, RTDs are individually packaged pre-mixed spirits, supplied in either a can or bottle. The manufacturing process is similar to that required to produce a soft drink.

30. All industry participants noted that the growth of RTDs has been fostered by Independent, and the other alcoholic suppliers have largely overlooked these types of products. In this respect, Independent has developed the RTD category in New Zealand largely on its own.

31. Industry participants also noted that since the supermarkets have sold beer, the retailing of alcoholic products has become increasingly fragmented. In this respect, retailers have looked to promote other products as a 'point of difference' from the supermarkets. In particular, RTDs have become a focus for many non-supermarket retailers.

PREVIOUS COMMISSION DECISIONS

32. The Commission has recently considered a number of applications in respect of the alcohol industry, namely:

  - *Decision 552: Fortune Brands, Inc / Pernod Ricard S.A*, 8 July 2005 (the Fortune Decision); and
  - *Decision 553: Pernod Ricard S.A / Allied Domecq plc*, 13 July 2005 (the Pernod Decision).

33. In both these Decisions, the Commission considered there to be discrete markets for individual spirits such as gin or bourbon. The Commission noted that this approach was consistent with its previous assessments in this industry and the approach used by other jurisdictions when analysing spirit products.

34. The Commission granted clearance in the Fortune and Pernod Decisions as it considered that the acquisitions would not lead to a substantial lessening of competition due to the strength of existing competition, primarily from large international competitors with an established presence in New Zealand.

MARKET DEFINITION

35. 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]

36. 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, 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 a 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.

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

Product Market

37. 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.

38. 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.

39. 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.

40. The Applicant submitted that the relevant markets are the production or importation of RTDs and spirits for wholesale supply to general liquor retailers, and the production and wholesale supply of beer to general liquor retailers and to supermarkets.

41. The Commission has typically defined discrete product markets for each category of alcoholic beverage. For example, separate product markets for beer, sparkling wine and separate markets for individual spirits such as gin and bourbon.

42. The Applicant advised the Commission that there is an increasing interrelationship between the various alcoholic beverage categories such as beer, wine, spirits and in particular RTDs.

43. The Applicant also submitted that on the demand-side, there is significant overlap between each category of alcoholic beverage. In this respect, end-consumers have a repertoire of alcoholic beverages from which they choose and the selection of their preferred beverage is dependent on the particular drinking occasion.

44. Other industry participants also considered that consumers have an increasing repertoire of alcoholic beverages. However, this repertoire varies between different consumers. No industry participant was able to provide empirical evidence that accurately quantifies consumer preferences. Nevertheless, all industry participants advised the Commission that the alcohol markets are ‘grey’ and difficult to define, particularly in relation to RTDs.

45. The Applicant submitted that, while noting the wide alcoholic beverages context, the relevant product markets are:

    - RTDs;
    - discrete markets for each type of spirit (eg gin, brandy, vodka); and
    - beer.

46. The Commission notes that Independent supplies a number of wine products, as does the Applicant. However, the Commission conducted market inquires and considers that the level of aggregation to be insignificant. To this extent, for the purposes of the present application, the Commission does not intend to define or consider wine products further.

RTDs

47. RTDs are individually packaged pre-mixed spirits, supplied in either a can or bottle. The Applicant supplied recent consumer surveys that indicate that RTD consumers have the most extensive drinking repertories – this may suggest that on the demand-side, RTDs could be part of a wider alcoholic beverages market.

48. The Commission has not previously considered acquisitions in respect of RTDs. The Commission notes that in other parts of the world RTDs do not have the same prominence in the alcohol industry as they do in New Zealand. In this respect, no other jurisdiction has assessed these products to any great extent.

<u>Differentiated/Undifferentiated Products</u>

49. Differentiated product markets are those in which the product offerings of suppliers varies to some degree and in which buyers make their purchase decisions on the basis of product characteristics as well as price. Suppliers' products are imperfect substitutes for one another and less close substitutes impose a lesser competitive constraint than others.

50. A "chain" of substitutes may be evident and, if there is no obvious break in the chain, there may be no obvious point where the boundary of the market can be drawn. If the competition analysis of an acquisition is sensitive to the market definition used, the Commission might not define the market precisely and might instead focus on the competition analysis and the impact of the acquisition on prices.

51. As set out in the Commission's Mergers and Acquisitions Guidelines, "this approach recognises that in a differentiated product market, a structural analysis that takes into account market definition and market share may not be as helpful in judging market power as one that focuses on the degree of substitutability between products, and on the amount of competitive constraint that each imposes upon the others."

52. Industry participants advised the Commission that RTD products are the main growth area in the alcohol industry. However, this growth has been fostered by Independent, which has grown the RTD category largely on its own through the supply of low price products. In this respect, industry participants advised that the demand for RTDs is very price driven.

53. The Commission understands that RTD products are characterised by examples that would indicate differentiated products. For example:

- all competitors supply a range of RTDs based on different base spirits, such as bourbon, vodka and gin;
- competitors also supply the same flavour RTDs but with different base spirits. For example, there are berry flavoured RTDs that are made from either vodka, rum or gin;
- the alcohol content varies between products. For example, Independent has a high-alcohol bourbon and cola product called 'Cody's', which has an alcohol content of 12% in comparison to other RTDs, which typically have an alcohol content of around five percent;
- packaging varies between products such as 700ml bottles, packs of four 275ml bottles, and boxes of a dozen cans; and

- Independent has recently introduced a low sugar product.

54. Industry participants advised the Commission that it is relatively easy for a manufacturer of one particular spirit RTD (eg a vodka RTD) to switch to manufacturing a different type of spirit RTD (eg a gin RTD). The Commission understands that, other than the addition of the spirit, the manufacturing processes are similar for all RTDs.[9] Industry participants also advised the Commission that bulk spirits and the other ingredients required to produce RTDs are readily available.[10]

55. In addition, the Commission does not consider that defining a spirit-based RTD product market would best enable it to identify any competition concerns which may arise from this proposal. For instance, most competitors supply a variety of RTDs with different spirit bases.

56. Industry participants advised the Commission that most suppliers of RTD products are associated with a 'mother brand' while Independent products are typically non-branded. For example, Lion supplies both Smirnoff vodka (a spirit) and Smirnoff Ice (a RTD) whilst Maxxium supplies Jim Beam bourbon and the associated bourbon RTD, Jim Beam & Cola.

57. Industry participants advised the Commission that products associated with a 'mother brand' are typically more expensive than products without a brand. For example, Maxxium's Jim Beam and Cola RTD is typically more expensive than Independent's equivalent Woodstock and Cola product.[11]

58. The Commission considers that although RTD products are differentiated to some extent, the differentiation is not sufficient to prevent the different products from being substitutable for each other. In this respect, the various products are not so differentiated that they should fall in discrete markets.

59. Accordingly, the Commission considers that RTDs are likely to fall within a differentiated product market in which the products have different base spirits, packaging, taste and price points.

60. The Applicant submitted that on the supply-side the techniques used to produce RTDs are not complex. Industry participants advised that RTDs are manufactured in the same manner as soft drinks. For example, [ ] performs contract bottling for soft drink companies on the same production line it uses for RTDs.

61. Essentially, a spirit is mixed with sugar, flavouring and water to produce the desired RTD. In this respect, the Commission considers that there is a strong degree of supply-side substitutability between RTDs and soft drinks.

62. However, the Commission notes that children and adolescents are restricted by law from purchasing alcoholic products, including RTDs. The Commission considers that due to this demand-side constraint there is a limited degree of

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[9] The Commission notes that some spirits are more difficult to manage than others. For example, bourbon is more volatile than gin or vodka and is required to be stored in a protective 'bunker'.

[10] The Commission understands that the supply of authentic Kentucky bourbon is constrained as typically only a few manufacturers wholesale their bourbon to third parties. As such, Kentucky bourbon is not as readily available as gin or vodka. However, as shown by the recent entry of DB, access to Kentucky bourbon is not insurmountable.

[11] The Commission notes that this may alter in the case of promotions.

substitutability between soft drinks and RTDs, or soft drinks and other alcoholic products.

63. The Commission notes that the Applicant considered that there are strong constraints on RTDs from other categories of alcoholic beverages. The Applicant considered this is primarily due to RTDs' convenience focus, being essentially a spirit and a mixer, with the 'look and feel' of a packaged beer.

64. While acknowledging that there are arguments in favour of both a narrow and broad product market, the Commission considers that for the purposes of the present Application, the relevant competition effects are best identified by defining a discrete product market for all RTDs. The Commission considers that if the competition concerns are not identified within this product market, they are unlikely to arise in a more broadly defined market.

65. Accordingly, the Commission considers that for the purpose of assessing the competition implication of the proposed acquisition, the appropriate product market is RTDs.

Spirits

66. The Applicant submitted that there would be aggregation in respect of the product markets for gin, vodka, Scotch whisky, bourbon, rum, brandy and liqueurs.

67. The Commission has previously considered there are discrete product markets for individual spirits eg gin, bourbon etc.[12] The Commission notes that this approach is consistent with that used by other jurisdictions when analysing these products.

68. For example, the European Commission considered that the product markets should be no wider than the individual internationally recognised main spirit types and this definition is preferred to other alternatives such as a broad distinction between 'white' and 'dark' spirits. A distinction based on the quality of the product was also deemed inappropriate as the quality of the product forms part of a continuum from which consumers make purchase decisions.[13]

69. The Commission considers that there have been no significant developments in this industry to warrant a change to the Commission's previous market definitions.

70. Accordingly the Commission is of the view that it is appropriate to define distinct product markets for gin, vodka, bourbon, Scotch whisky, rum, brandy and liqueurs.

Beer

71. The Commission previously considered beer in Decision 182[14]. Given the length of time since this previous decision, the Commission considers it appropriate to reassess the relevant product market.

72. The Applicant submitted that beer can be characterised into three general categories - budget, mainstream and premium. The Commission understands

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[12] See the Fortune Decision and the Pernod Decision.

[13] See European Commission, Case No. IV/M.938, Guinness / Grand Metropolitan, 15 October 1997, and Case No. IV/M.2268, Pernod Ricard /Diageo /Seagram Spirits, 8 May 2001.

[14] See *Decision 182: Magnum Corporation Limited / Dominion Breweries Limited*, 25 November 1986.

that beer is characterised by examples that would indicate differentiated products, in much the same fashion as RTDs (and wine[15]), namely:

- taste - for example, ales, lagers or a pilsener;
- content - beer can be low alcohol, low carbohydrate or low calorie as distinct from mainstream beer; and
- packaging - some beer is supplied to retailers in bulk as well as pre-packaged, such as cans, 330ml ‘stubbie’ bottles and crates.

73. The Commission also notes that beer is supplied along a number of different price points but these different prices (and qualities) form a chain of substitution across the entire beer category such that beer falls within the same overall market. In addition, the Commission notes that determining which beers are ‘premium’ and which beers are ‘budget’ is a fairly arbitrary process.

74. The Commission understands that other jurisdictions consider the relevant product market to be beer.[16] In 2005, the ACCC did not consider it appropriate to define a narrower market for products such as ‘standard’ and ‘premium’ beer products noting that, on the supply-side, it is likely that a (hypothetical) producer of standard beer could commence supplying a premium beer with a minimal amount of investment.

75. Accordingly, the Commission considers the relevant product market to be beer.

Conclusion on Product Markets

76. The Commission concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product markets are:

- RTDs;
- individual spirits (gin, vodka, bourbon, Scotch whisky, brandy, rum, and liqueurs); and
- beer.

Functional Market

77. The production, distribution and sale of a product typically occurs 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. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

78. Industry participants advised the Commission that the supply of alcoholic products occurs in a number of ways. For example, some suppliers manufacture their own brands, some manufacturers supply certain products through a licence agreement with a brand owner, whilst other competitors import particular products. The Commission considers all these methods compete with one

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[15] See the Pernod Decison.

[16] See European Commission, Case No. Comp/M.3372, Carlsberg / Holsten, 16 March 2004 and Australian Competition and Consumer Commission (ACCC), Public Competition Assessment, Lion / Coopers Brewery Limited, 21 December 2005.

another and, as such, there is no distinction between domestic manufacture and importation.

79. Lion and Independent manufacture, import and distribute a range of beer, spirit and RTD products. Accordingly, the Commission considers that, for the purposes of the present application, the relevant functional level is the manufacture/importation and wholesale supply of each product.

Geographic Market

80. 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.

81. All relevant competitors of beer, spirits and RTDs distribute, promote and price their products nationally. In addition, the Commission has previously considered that alcohol products are relatively high in value (in comparison to the freight costs) and can be transported economically.[17]

82. Accordingly, the Commission considers that it is appropriate to define all relevant markets as being national in extent.

Conclusions on Market Definition

83. The Commission is of the view that the relevant markets are the national markets for the manufacture/importation and wholesale supply of:

- RTDs (the RTD market);
- individual spirit markets for gin, vodka, bourbon, scotch whisky, brandy, rum, and liqueurs; and
- beer (the beer market).

COUNTERFACTUAL AND FACTUAL

84. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (the counterfactual).[18] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

85. In the factual scenario, Lion would acquire the business of Independent. This would include the acquisition of a range of different products including RTDs, gin, vodka, Scotch whisky, bourbon, rum, brandy, liqueurs, and beer.

86. Lion submitted the application before any (potential) tender offer by Independent
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[17] For example, see *Decision 401, Montana Group (NZ) Limited / Corban Wines Limited*, 6 September 2000, and the Pernod Decision.
[18] *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No 6)*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

Counterfactual

87. Industry participants advised the Commission that there was widespread speculation about the future of Independent. However, Independent advised the Commission that, although it is selling off its operations in the United Kingdom [ ], it has not made any formal decision to sell the New Zealand or Australian operations.

88. In this respect, the Commission considers that the likely counterfactual scenarios include:

- the continuation of the status quo. Independent advised the Commission that it had not initiated a tender process and it was continuing to operate on a 'business as usual' basis; and
- the sale of Independent to a third party that is not already present in the industry. Industry participants advised the Commission that they considered that Independent will definitely be offered for sale in the short term and that the main consideration is timing, rather than whether a sale will occur. In addition, [ ]

89. The Commission does not consider that the above outlined counterfactual scenarios pose any significant differences for the competition analysis of this application.

90. Accordingly, the Commission considers that the relevant counterfactual is Independent supplying the relevant markets either under its present ownership or owned by a non-industry third party.

COMPETITION ANALYSIS

Existing Competition

91. 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).

92. 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.

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

- 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 40% share; or
- 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%.

94. 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 the behaviour of the businesses in the market.

95. Industry participants advised the Commission that the most appropriate measurement of market share in this industry is volume and this data is commonly used to deduce market share information. The standard method is to measure volume in terms of nine litre equivalent (9le) cases where one case equals twelve 750ml bottles. In respect of beer, litres are commonly used.

The RTD Market

96. The main competitors in the RTD market are Lion, Independent and Maxxium with a number of other competitors also supplying the market such as Hancocks, DB and Foster's.

97. Table 1 shows the estimated market share for the RTD market for the 2005/2006 year.

Table 1: Estimated Market Shares for the RTD Market

Supplier	**Notable Brands**	**Volume (9le cases)**	**Market Share**
Lion	Coruba, Smironff Ice, Archers, Gordon's, Johnnie Walker, Baileys, Stoli Ruski	[ ]	[ ]
Independent	Woodstock, Cody's, Cruiser, KGB, Purple Goanna, Vodka Mudshake, Fighting Cock, Pulse, Tatoos	[ ]	[ ]
Combined Entity		*[ ]*	*[ ]*
Maxxium	Jim Beam, Midori	[ ]	[ ]
Hancocks	Jack Daniels, Bacardi Breezer, Southern Comfort	[ ]	[ ]
Other	Foster's, DB, Pernod Ricard	[ ]	[ ]
Total		[ ]	100%

Source: Industry participants

98. Table 1 indicates that, post-acquisition, the combined entity would have a market share of [ ] and the three-firm concentration ratio would be [ ]. This is outside the Commission's safe harbours.

99. Essential to the way in which Lion and Independent compete in the counterfactual is the difference in their corporate structure and business model. Market participants highlighted Independent's agility, nimbleness, innovation, its focus and timeliness in getting new products to market, which will be arguably difficult for Lion to replicate in the factual scenario.

100. Super Liquor and The Mill advised the Commission that RTD products have experienced significant growth in the industry and this growth has been predominantly by Independent's products. Currently, Independent's products

make up the bulk of the available RTD products in New Zealand, approximately [ ], and are typically lower cost, non-branded products.

101. Lion, Maxxium, Hancocks, Foster's and Pernod Ricard supply mainly mother-branded RTD products. For example, Maxxium supplies Jim Beam RTD, Hancock supplies Bacardi Breezers and Lion supplies Smirnoff RTDs. These products are typically more expensive, target a more sophisticated consumer and tend to position themselves at the upper end of the RTD market.

102. Independent's success with its non-branded products has distinguished it from other suppliers. Typically, Independent competes at the lower end of this market. Despite this, the Commission notes that there appears to be competition between RTD suppliers. This is evidenced by the fact that if one supplier develops a new type of product (for example, new packaging or a new flavour) other suppliers follow. The Commission understands that the RTD market is dynamic and RTD consumers appear to be particularly receptive to change and experiment with new products.

103. The Commission considers that, in the counterfactual, Independent would be the key player in the RTD market. Independent advised the Commission that it would continue to compete with competitively priced non-branded products and its position as an innovator and product leader is likely to continue.

104. In the factual scenario, Lion would have a considerable addition to its already broad portfolio of products, namely Independent's RTDs. The combined entity would have a market share of approximately [ ] of RTD products and would supply both branded and non-branded products.

105. The Commission understands that the sale of bourbon based RTDs has been the strongest growth area in RTDs. These products now account for approximately half of all sales in this market. In the factual, Lion would obtain Independent's Woodstock brand, which is the leading product in the market with approximately [ ] market share.

106. Industry participants have queried the extent to which Lion would be able to continue Independent's business model post-acquisition; specifically, whether Lion would be able to match Independent's innovation and the speed with which it gets new products to market. For example, Independent advised the Commission that it can develop and get a new product to retailers [ ]

Barriers to expansion

107. The ability of competitors to compete with Lion post-acquisition would depend on their ability to expand sufficiently to prevent Lion exercising any market power.

108. The Applicant submitted that there is a high likelihood of continued growth and expansion in the RTD market. Lion submitted that existing competitors could grow their current market share relatively easily by expanding their existing supply or developing new products.

109. Industry participants supported this view, advising the Commission that manufacturing RTDs is a relatively simple process. As noted in the market definition section, essentially all RTDs can be produced using the same equipment.

110. To manufacture and increase the production of RTDs, suppliers require access to:

- base spirits;
- ingredients and mixers; and
- bottling or canning facilities.

111. Lion submitted that manufacturers seeking to expand could do so either through expanding a local production base or increasing volumes of imported products.

112. Independent, Lion and DB all produce RTDs domestically. Base spirits can either be manufactured locally or obtained from an international supplier. Whilst most white spirits (such as vodka and gin) are relatively easy to obtain, the Commission understands that access to bourbon is more problematic due to the nature of the production process.

113. For example, the supply of Kentucky bourbon usually requires ‘take or pay’ contracts with a supplier, which generally means a competitor must pay up front (for future delivery), or pay for a minimum supply of bourbon. Industry participants advised the Commission that existing purchasers tend to get preferential treatment in terms of bourbon supply contracts. For example, [ ] However, as previously noted in regards to the recent entry of DB, access to bourbon is not insurmountable. In this respect, the Commission does not consider that obtaining bourbon amounts to a significant barrier to expansion in the RTD market.

114. Industry participants advised the Commission that obtaining ingredients, such as carbonated mixers or flavourings, is relatively simple and represents a small portion of the total cost of RTDs. For example, ingredients such as a cola mix are readily available from international flavour houses. In this respect, the Commission does not consider that access to ingredients represents a barrier to expansion.

115. Industry participants also advised that existing suppliers have excess bottling and canning capacity in New Zealand. For example, DB advised the Commission that its recent entry in the RTD market has been successful [ ] Accordingly, the Commission does not consider that this amounts to a barrier to expansion for existing competitors.

116. A number of participants, including Lion, Hancocks and Foster’s, import RTDs. The Commission notes that these imports are typically products associated with a mother-brand and as such tend to target the higher end of the RTD market. In this respect, [ ] questioned whether it would be viable to import RTDs to compete at the same price point as Independent products.

117. Currently, Lion imports most of its RTDs and advised the Commission that suppliers, like itself, are not constrained in their ability to import RTDs into New Zealand. For example, Lion has [ ] its Smironoff RTD imports in the last two years. In this respect, the Commission considers that imports are a credible source of competition in the RTD market.

118. The Commission does not consider that there are any significant barriers to importing RTDs, and considers existing competitors have the ability to increase the volume of RTD imports if given an incentive to do so.

119. Accordingly, the Commission considers that existing competitors, whether through importation or domestic production, are not constrained in the manufacture of RTDs and could expand their existing operations, given an incentive to do so.

120. A substantial aspect of competing in the liquor industry, and accordingly, in the RTD market, is getting products to market. This consists of firstly, a distribution network, and secondly, having access to sales channels. Industry participants have advised the Commission that access to sales channels is the most difficult aspect of competing.

Distribution

121. Typically, suppliers self-distribute their products directly to their customers. However, it is also common for suppliers to utilise the services of a third party distributor, either a pure alcoholic beverage distributor such as Tasman Liquor Company Limited (Tasman)[19], or a general grocery wholesaler which also sells other (non-alcoholic) products.

122. The Commission notes that liquor distribution in New Zealand appears to be primarily volume based – smaller volume sales are distributed via third party distributors, whereas larger volume sales are typically self-distributed directly. For example, [ ] advised the Commission that although its sales force discusses the marketing and promotional activity of its brand directly with retail outlets, when customers are only ordering small quantities it is more economical for both it and the retailer to use the services of Tasman.[20]

123. Industry participants advised the Commission that increasing their warehousing, transportation and sales capabilities would be relatively easy, as it would simply involve expanding on their existing relationships. Therefore, the Commission considers that an existing player that already has a distribution network would find it relatively simple to expand its network to distribute an increased supply of RTDs.

Access to sales channels

124. Market participants consistently expressed a view that the most difficult part of supplying any alcoholic product is obtaining access to sales channels – essentially, getting the product on the shop floor. This requires obtaining agreement from retailers, third party distributors and on-premise outlets to stock a particular product.

125. Several industry participants, [ ], raised concerns that access to the relevant sales channels would be further restricted post-acquisition due to the combined entity's enhanced economies of scope. In the factual, Lion would be the only supplier with a large portfolio of alcoholic beverages and, arguably, may have an advantage over single good suppliers.

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[19] Tasman wholesales products for most suppliers in New Zealand and currently has a turnover of approximately [ ] per annum.

[20] The Commission notes there are some notable exceptions. For example, Pernod Ricard advises all its non-supermarket customers to use Tasman.

126. There are two main types of retail outlets for suppliers[21], namely:

- off-premise outlets, such as bottle stores and supermarkets; and
- on-premise outlets, such as bars and restaurants.

Off-premise outlets

127. The Commission understands that access to sales channels is influenced by a number of factors, including:

- reputation - [ ] advised the Commission that it considered if a company's product and branding was strong enough then the sales channel would be available. Reliability of supply and the reputation and existing relationship with the supplier are also considered important;
- marketing – emphasis is placed on the marketing of these products and suppliers use a variety of different strategies. Independent does not invest significant resources into 'above the line' advertising but focuses on direct marketing to retailers. Lion and DB use more traditional methods such as billboard advertising and sponsorship of sports teams in addition to in-store promotions, inducements and tastings ; and
- rebates and discounts may be offered to retailers by suppliers if volume and financial targets are achieved.

128. The Commission notes that RTDs have greater prominence in the off-premise channel and consequently, an existing competitor's ability to expand in the RTD market may be affected by Lion's increased economies of scope in respect of off-premise outlets.

129. However, the Commission notes that existing suppliers have established relationships with a number of different retailers and wholesalers. In this respect, the Commission considers that, post-acquisition, competitors can utilise these relationships to enable them to expand in the RTD market.

130. [ ] advised the Commission that advertising space is currently limited and that Lion's increased portfolio of products in the factual may further restrict this availability.

131. Industry participants advised the Commission that it is a common tactic for all suppliers to offer retailers inducements and giveaways, rather than engaging in 'above-the-line' advertising. For example, suppliers provide fridges to retailers in which to display their products. Independent advised that it does not advertise any of its RTDs directly, preferring to promote its products in retail stores. In this respect, the Commission considers that these are viable options to be utilised to counter any reduction in promotional space.

132. The Commission understands that retailers want to offer end-consumers a range of products. In this respect, retailers are incentivised, in both the factual and counterfactual scenarios, to offer suppliers advertising slots, promotional space and floor space to sell their products. As such, the Commission considers that existing competitors would not be restricted in their ability to supply the market, post-acquisition, as a result of Lion's increased portfolio of products.

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[21] The Commission understands that manufacturers/importers do not make a distinction between the supply to either type of retail outlet as sales are, typically, based on quantity rather than customer type.

On-premise

133. Access to on-premise outlets is sometimes subject to alignment agreements between bars (and restaurants) and the relevant supplier. For example:

- Lion submitted that it has alignment agreements with [ ] of the on-premise outlets with which it trades; and
- alternatively, an outlet may have two or three agreements with different suppliers for different products eg one for wine, one for beer and one for spirits. For example, [ ] has an agreement with DB for beer, Hancock's for spirits and it sources wine from a number of producers.

134. The most common agreement is between the respective breweries, Lion and DB, and various on-premise establishments, although these agreements vary in both nature and strength. The strongest of these agreements is known in the industry as a 'soul-less' bar, in which a bar guarantees exclusive access for a supplier's products in exchange for a financial contribution[22].

135. These alignment agreements enable suppliers to bundle their most popular products with their least popular products. In practice this means suppliers can structure their alignment agreements so if an outlet wants to stock product X, they must also stock product Y. This is commonly referred to in the industry as 'tying'.

136. In the factual, Lion would be the only supplier with a complete portfolio of alcoholic beverages, including a considerable range of products in all the relevant markets (ie a large beer range, spirits in all categories, and the main supplier of RTDs).

137. [ ] advised the Commission that the impact of Lion's increased portfolio of goods in the factual will further restrict access to sales channels. It considered that Lion would tie its existing products with its new RTDs, thereby preventing access to the sales channels by other competitors, which would give Lion a competitive advantage.

138. Specifically, industry comments suggest that in the factual it would be difficult for Lion's competitors to sell their RTDs in Lion-aligned bars because Lion would be likely to supply these bars with an increased range of RTD products.

139. Independent advised the Commission that its sells a high proportion of its RTDs, approximately [ ], through off-premise outlets. In this respect, the Commission considers that the effect of the acquisition on on-premise outlets is likely to be minimal, as Independent has a negligible presence in this sales channel.

140. The Commission notes that Independent's limited presence in the on-premise sales channel has not restricted its growth. As such the Commission does not consider that access to this sales channel is essential in order for existing competitors to expand in the RTD market.

141. Several industry participants suggested that Lion obtaining Independent's products as part of its portfolio may be a disadvantage, as bars and restaurants don't necessarily want to deal with RTDs. For example, the Commission notes

[22] This could include an interest free loan or a market services agreement, in which the value of the liquor an outlet sells is written off against the total amount borrowed.

that many on-premise outlets still prefer their bartenders to 'create' a drink for end-consumers rather than to offer an RTD.[23]

142. [ ] advised the Commission that it considered that barriers to expansion may be lower in the factual, as there would be only one major player, rather than competition between two players. The Commission also notes that [ ]

143. The Commission understands that the two supermarket chains in New Zealand are currently in the process of establishing liquor retail outlets. These stores will be selling RTDs and spirits (in addition to beer and wine). Currently, supermarkets are restricted from selling RTDs and spirits.

144. For example, all three of the Foodstuffs cooperatives are planning entry into general liquor retailing before the end of this year.[24] In addition, Progressive Enterprises Limited has publicly announced that it is in the advanced stages of introducing similar format stores.[25]

145. [ ]

146. The Commission has previously noted the countervailing power of the two supermarket chains in respect of the alcohol industry, particularly in regards to sales of wine.[26] The Commission considers that this countervailing power would flow over into these new retail ventures.

Conclusion on Existing Competition

147. The Commission considers that due to the ease of supply of RTDs and the ease with which existing competitors can expand their distribution networks, there is unlikely to be any significant difference in the manufacture/importation and wholesale supply of RTDs between the factual and the counterfactual scenarios.

148. While the Commission recognises that the enhanced economies of scope resulting from the acquisition would give Lion a competitive advantage, the competitive advantage is not considered sufficient to amount to a barrier to expansion.

149. The Commission considers that Independent's limited presence in the on-premise outlets has not restricted its growth. In addition, the Commission does not consider that the acquisition would restrict existing suppliers from utilising their established relationships with retail outlets to ensure continued access to the relevant sales channels.

150. Accordingly, the Commission considers that existing competition is likely to provide significant constraint on the combined entity post acquisition, due to the ease of expansion by existing competitors.

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[23] The Commission considers this is indicative of how on-premise outlets attempt to differentiate themselves at the retail level.

[24] Foodstuffs (Wellington) Cooperative Limited opened the first of these stores in August. Other stores are expected to open in Auckland and Queenstown before the end of the year.

[25] For example, see Sue Allen, Woolworths ready for war, *Dominion Post*, 22 August 2006.

[26] See the Pernod Decision.

The Spirit Markets

151. The main competitors in the spirits market are Lion, Independent, Pernod Ricard, Maxxium, Hancocks and Foster's.

152. These competitors are either brand owners, such as Pernod Ricard or Maxxium, who supply their own product, or licence holders, such as Lion, Hancocks and Foster's, who typically supply brands into New Zealand on behalf of a brand owner.

153. Independent's products are primarily budget brands that compete against high profile international brands, supplied by the competitors listed above.

154. Table 2 shows the estimated market shares for each of the respective spirit markets for the 2005/2006 year.

Table 2: Estimated Market Shares for the Spirit Markets

Supplier	Gin	Vodka	Scotch	Bourbon	Brandy	Rum	Liqueurs
Lion	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Independent	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined Entity	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*
Pernod Ricard	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Maxxium	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Hancocks	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Foster's	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	100%	100%	100%	100%	100%	100%	100%
Total (9le cases)	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]

Source: Industry participants

155. Industry participants did not express any concerns in regards to the proposed acquisition in respect of the manufacture of any of the spirits identified above. Industry participants advised that the main source of competition in each of these spirit markets is between international brands, and that Independent has a minimal presence in the respective markets.

156. Industry participants stated that, in each of the markets identified above, there are a number of competitors, who each have a strong international presence. However, the Commission notes that competition within each market varies depending on which international brand is strongest. For example, Maxxium has a strong presence in bourbon with its Jim Beam brand, while Lion is strong in both the gin and rum markets with its Gordon's gin and Coruba rum brands.

157. The Commission understands that in the factual scenario, no competitor would be constrained in its ability to supply the relevant spirit market and all could increase their supply, given an incentive to do so. In this respect, the Commission considers that the effect of the proposed acquisition to likely to be de minimis.

158. In addition, as discussed above under RTDs, the Commission considers that the access to the relevant sales channel does not represent a significant barrier to expansion.

Conclusions on the Spirits Markets

159. Accordingly, given the strength of existing competitors and their ability to increase their supply, the Commission is satisfied that there is unlikely to be a substantial lessening of competition as a result of the proposed acquisition in any of the respective spirit markets.

The Beer Market

160. The main competitors in the beer market are Lion and DB with Independent and Foster's also supplying the market.

161. Industry participants advised the Commission that there are a number of small manufacturers also supplying the beer market. These suppliers are typically referred to as 'micro-breweries'. The Commission notes that these manufacturers have only a minimal presence in the beer market.

162. Industry participants stated that, historically, Lion and DB have been the two main competitors in this market. The Applicant advised the Commission that, in both the factual and counterfactual scenarios, competition between DB and Lion would continue to be strong.

163. Table 3 shows the estimated market share for the beer market for the 2005/2006 year.

Table 3: Estimated Market Shares for the Beer Market

Supplier	Notable Brands	Volume (million litres)	Market Share
Lion	Speight's, Lion Red, Steinlager, waikato, Canterbury Draught Stella Artois, Guiness, Mac's, Corona, Beck's	[ ]	[ ]
Independent	Ranfurly, NZ Lager, Tuborg, Carlsberg, Kingfisher, Grolsch, Haagen	[ ]	[ ]
Combined Entity		*[ ]*	*[ ]*
DB	Tui, Export Gold, Heineken, DB Draught, Monteith's, Double Brown, Amstel, Flame	[ ]	[ ]
Foster's	Foster's, Victoria Bitter, Crown	[ ]	[ ]
Other		[ ]	[ ]
Total		[ ]	100%

Source: Industry participants

164. Table 3 indicates that, post-acquisition, the combined entity would have a market share of [ ] and the three-firm concentration ratio would be [ ]. This is outside the Commission's safe harbours.

165. The Applicant submitted that there is a proliferation of varieties and brands of beers available in New Zealand. In this respect, consumers would have a

plethora of choice in both the factual and counterfactual scenarios. Lion noted that, while some consumers are brand loyal, there is a high degree of switching between brands.

166. Independent only has a small presence in the beer market. Independent advised the Commission that the majority of its beer sales are in the budget end of the market. For example, its budget brands, New Zealand Lager and Ranfurly draft, account for [ ] of Independent's beer sales.

167. However, Independent has recently increased its overall market share through the manufacture, under licence, of international brands such as Carlsberg, Haagen and Tuborg. Independent also has the New Zealand licence to import Grolsch. The Commission understands that premium beer is the growth area in the beer market, where DB's Heineken is the leading brand.

168. The Applicant submitted that existing competitors in the beer market have the ability to expand their presence in the market noting that, post-acquisition, both DB and Foster's would impose sufficient constraint on the combined entity.

169. Industry participants advised that although Foster's is the market leader in Australia, it has been relatively unsuccessful in New Zealand. One of the reasons for this performance was considered to be parochialism and there has been traditionally a resistance to drinking beer from 'across the ditch'.

170. Currently, Foster's imports all its beer products into New Zealand. Foster's advised the Commission that the size and packaging of its mainstream beers in Australia are quite different[27]. As such, Foster's pricing is typically more expensive than domestic products. However, the Commission notes that this may alter in the case of promotions.

171. Foster's stated that this price differential is compounded by the additional cost of freight and is one of the reasons Foster's has not been able to replicate its success in Australia. Foster's advised the Commission that it [ ]

172. [ ] advised the Commission that, in respect of premium beer brands, there are numerous products available. For example, [ ] imports [ ] international brands that are price competitive with domestically produced premium products. [ ] considered that there are no significant barriers to importing beer into New Zealand[28].

173. Industry participants advised the Commission that the sales channel for beer has become more accessible as a result of legislative changes in 1999. For example, the number of independent retail outlets has increased and the Commission notes that The Warehouse has also recently started retailing beer and wine (but not spirits) in selected stores.

174. The Commission understands that supermarkets now account for approximately 40% of beer sales. [ ] sales are made on promotion and any attempt to raise price would likely result in reduced volumes (and therefore possible deletion).

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[27] For example, Foster's typical bottle is 375ml in comparison to the New Zealand standard 330ml bottle.

[28] [ ]

175. The Commission understands that Lion and DB are the main two competitors in respect of sales to on-premise outlets. In this respect, the Commission considers that there is unlikely to be any change between the factual and counterfactual scenarios because Independent, typically, does not supply to on-premise outlets.

176. The Commission understands that there are a number of ‘micro-breweries’ manufacturing beer throughout the country. Industry participants advised that currently, these suppliers provide only a limited constraint on Lion and DB and the acquisition is unlikely to change this. In this respect, the Commission is of the view that the possible expansion of a smaller competitor is unlikely to constrain the combined entity.

177. However, the Commission considers that the presence of DB is likely to constrain the combined entity. The Commission notes that absent Independent’s entry into the market, Lion and DB competed vigorously and this is likely to continue, post-acquisition.

Conclusions on Existing Competition

178. The Commission notes that although there are smaller competitors in this market, notably Foster’s, micro-breweries and exclusive imports, these competitors would provide only a limited constraint on the combined entity.

179. The Commission considers that, post-acquisition, DB would continue to be a strong competitor in the beer market. DB has an established presence in the market and it is not constrained by capacity considerations. Therefore, DB would provide sufficient constraint to any attempt by the combined entity to exercise market power.

OVERALL CONCLUSION

180. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the national markets for the manufacture/importation and wholesale supply of:

- RTDs (the RTD market);
- individual spirit markets for gin, vodka, bourbon, Scotch whisky, brandy, rum, and liqueurs; and
- beer (the beer market).

181. Independent has not announced that it is for sale but there is widespread speculation that it will be sold in the short-term. However, the Commission considers that the competition effects in the counterfactual would be similar in either scenario; whether Independent continues under its present ownership or owned by a non-industry third party.

182. In respect of the RTD market, the Commission recognises that the enhanced economies of scope resulting from the acquisition would give Lion a competitive advantage. However, this competitive advantage is not considered sufficient to amount to a barrier to expansion. The proposed acquisition would not restrict existing suppliers from utilising their established relationships with retail outlets to ensure continued access to the relevant sales channels.

183. The Commission considers that due to the ease of supply of RTDs and the ease with which existing competitors can expand their distribution networks, there is

unlikely to be any significant difference in the supply of RTDs between the factual and the counterfactual scenarios.

184. Accordingly, the Commission considers that existing competition in the RTD market is likely to provide significant constraint on the combined entity, post acquisition, due to the ease of expansion by existing competitors.

185. In respect of the spirits markets, competition is mainly between international brands and this would continue post-acquisition. Accordingly, given the strength of existing competitors and their ability to increase supply, the Commission is satisfied that there is unlikely to be a substantial lessening of competition as a result of the proposed acquisition.

186. In respect of the beer market, the Commission considers that, post-acquisition, DB would continue to be a strong competitor in the beer market. DB has an established presence in the market and it is not constrained by capacity considerations. In addition, the Commission considers that, in both the factual and counterfactual scenarios, the main competitive dynamic in the market would be between Lion and DB. Accordingly, the Commission is satisfied that DB would provide sufficient constraint to any attempt by the combined entity to exercise market power.

187. The Commission is therefore satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the affected markets.

DETERMINATION ON NOTICE OF CLEARANCE

188. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Lion Nathan Limited to acquire up to 100% of the shares or assets of Independent Liquor (NZ) Limited.

Dated this 24th day of August 2006

Paula Rebstock
Chair
Commerce Commission