AUT/BA-T19/3
M:2355

MEMORANDUM

To:	Alan Bollard Peter Allport Roger Taylor Terry Stapleton
From:	Jo Bransgrove Jeff Orr Jane Chilcott
Date:	18 December 1997 (Working Day 19)
Subject	**Notice Seeking Clearance for the Proposed Acquisition of a Business:** **Tip Top Ice Cream Company Limited / United Dairy Foods Limited**

Working Day 20: 19 December 1997

Confidential material in this report is contained in square brackets.

INTRODUCTION

1 On 21 November 1997, the Commission registered a notice pursuant to s 66 of the Commerce Act 1986 (the Act) seeking clearance for Tip Top Ice Cream Company Limited (Tip Top) to acquire certain assets of United Dairy Foods Ltd (United Dairy).

2 Specifically, Tip Top is proposing to acquire the trade names and trade marks, goodwill and business assets associated with the take home ice cream wholesaling, manufacturing and distribution business of United Dairy.

BACKGROUND

3 On 24 September 1996, the Commission declined to give clearance for Tip Top to acquire the assets of New American Ice Cream Ltd (New American)[1] which included the business for take home ice cream. The Commission was not satisfied that the acquisition would not result in Tip Top acquiring dominance in the market for take home ice cream.

4 On 31 October 1996, the Commission cleared a modified acquisition proposal submitted by Tip Top.[2] The major difference between that application and the previous application was that Tip Top would acquire all of New American's manufacturing assets, but United Dairy, a wholly owned subsidiary of New Zealand Cooperative Dairy Company Limited (NZCDC), would continue to own and distribute New American's brand of take home ice cream with Tip Top being the contract manufacturer and packer.

5 Prior to the Commission determining the application, United Dairy submitted a business plan showing that it could profitably integrate New American take home ice cream into the range of products distributed and marketed by Country Foods New Zealand Ltd (Country Foods), another wholly owned subsidiary of NZCDC.

6 By letter dated 7 July 1997, NZCDC notified the Commission that the arrangement had not been successful and that they now wished to exit the take home ice cream market. Specifically, NZCDC alleged that some of the assumptions underlying the business plan were erroneous and the company was now incurring unsustainable losses. In the words of Pryme Footner, NZCDC's chief executive,

> "we have not been able to leverage synergies for the take home product in the Country Foods business to offset reductions in profit margins from lower than forecast sales volumes (over which to recoup fixed costs) and the increased discounts necessary to achieve even this lower than forecast sales volume. Substantial losses are now predicted to continue into next year, with the result that we have no option but to exit from this product."

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9 [ ] Tip Top has now applied to the Commission to acquire New American's remaining business assets. Tip Top argues that the Commission should clear the acquisition since take home ice cream market conditions have changed significantly in the past year such that dominance concerns should no longer arise by virtue of the acquisition. The changes in competitive conditions cited by the applicant consist primarily of the following:

- increased market share by significant competitors in the take home ice cream market at the expense of Tip Top and New American; and,
- imports of Street's take home ice cream by the Woolworths NZ Ltd (Woolworths) supermarket chain.

10 The remainder of the application consists of the same and/or further argument from previous applications regarding the appropriateness of including controlled label business in Tip Top's market share, constraint by supermarkets, and market definition.

PROCEDURES

11 Section 66(3) of the Act requires the Commission either to give clearance or decline to give clearance for the acquisition within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. Tip Top has agreed to provide the Commission with 20 working days to make a determination on the application. Accordingly, a decision on the notice is due by 19 December 1997.

12 This report concludes that staff are not satisfied that the proposed acquisition would not result, or would not be likely to result, in a person acquiring or strengthening a dominant position in a market, and recommends that, in terms of s 66(3)(b) of the Act, the Commission decline to give clearance for the acquisition.

THE PARTIES

Tip Top Ice Cream Company Limited

13 Tip Top is the largest manufacturer, distributor and wholesaler of ice cream in New Zealand. It manufactures a range of ice cream, frozen novelties and frozen desserts for distribution under the "Tip Top", "Peter's Country Club", "Peter Pan", "New American" (except in connection with take home ice cream) and "Movenpick" brands and various controlled labels.

14 Tip Top is a wholly owned subsidiary of Peters & Brownes Foods Limited (Peters) of Perth, Western Australia, which acquired the company from Heinz-Wattie Limited in April 1997. Peters is the third largest ice cream manufacturer in Australia behind Nestlé and Unilever. Peters manufactures and distributes ice cream in Western Australia under the "Peters" brand. It has no other business interests in New Zealand.

15 Tip Top has manufacturing facilities in Auckland and Christchurch. The Auckland plant, which operates at [ ]% of its maximum daily capacity of [ ] litres, produces ice cream generally for supply to North Island customers. The Christchurch plant, which operates at [ ]% of its [ ] litre maximum daily capacity, produces ice cream generally for export and for South Island supply.

16 Following the Commission's 31 October 1996 decision, Tip Top acquired New American's Auckland plant. At the time of Tip Top's last clearance application, the New American plant was operating at [ ]% of its maximum production capacity of [ ] litres per day. The plant is no longer operational. Most of the equipment from the New American plant has been moved to Tip Top's Auckland, Christchurch and Fiji plants with the remainder standing idle awaiting sale.

United Dairy Foods Limited

17 United Dairy formerly manufactured and distributed ice cream under the "New American" brand from its plant in Otahuhu, Auckland. Currently, United Dairy owns the remaining New American assets which have not already been acquired by Tip Top, including the New American brand, the Otahuhu factory lease and current inventories. The distribution and marketing of "New American" brand take home ice cream, which is contract manufactured and packed by Tip Top, is handled by Country Foods. United Dairy and Country Foods are wholly owned subsidiaries of New Zealand Dairy Foods Limited, which in turn is a wholly owned subsidiary of NZCDC.[3]

OTHER PARTIES

Domestic Manufacturers

Kiwi Icecream Company (1992) Limited (Kiwi)

18 Kiwi produces a range of ice creams and frozen novelties for distribution under the "Kiwi" brand name which is leased from Kiwi Co-operative Dairy Company . Kiwi is privately owned by a person who also owns a frozen food distributor, Newmarket Foods.

19 Kiwi recently purchased the Auckland manufacturing plant of Pacific Dairy, which went into receivership at the end of last year. At the time of purchase, Pacific Dairy's plant had a maximum capacity of [ ] litres per day. Accordingly, Kiwi has closed its Tauranga plant which had a lower maximum capacity of [ ] litres per day. Kiwi has transferred some of its Tauranga manufacturing equipment to Auckland and states that its plant can now manufacture [ ] litres of ice cream per day on [ ]. With little capital investment and increased labour the plant could be run on a [ ] basis, and produce up to [ ] litres per day.

Mel-O-Rich Products Limited (Mel-O-Rich)

20 Mel-O-Rich produces a range of ice creams for distribution under the "Mel-O-Rich" brand and also produces the "First Choice" and "No Frills" controlled labels for Woolworths.

21 Mel-O-Rich's manufacturing plant is located in Wellington. According to Mel-O-Rich, it has a maximum capacity of [ ] litres per day, but averaged only [ ] litres per day over the past 12 months. While the theoretical daily capacity of Mel-O-Rich's plant is [ ] litres, [ ] limit the plant's practical capacity to [ ] litres per day. Approximately [ ]% of its production is take home ice cream with the remainder being frozen novelties and bulk ice cream. Exports account for about [ ]% of total production.

Talleys Fisheries Ltd (Talleys)

22 Talleys, a frozen fish and vegetable manufacturer, is a relatively new entrant to the ice cream markets. In December 1995, Talleys opened its plant in Motueka, which cost approximately [ ] to build. According to Talley's, its plant has a maximum capacity of about [ ] litres per day, and it operates at [ ]% of this level, or [ ] litres per day. Talley's operates on a [ ] day a week schedule, which could be increased to [ ] days a week.

Chateau Creme Delight Ice Cream Co. Ltd (Chateau)

23 Chateau was established in 1975 by the grandson of the founder of New American ice cream, but is currently owned by the Gilbert family. It manufactures and distributes scoop ice cream from its Auckland facility. Chateau recently purchased Dairy Brand's premium natural ice cream business, including the "Killinchy Gold" brand (Killinchy). Killinchy is manufactured from Christchurch at a plant which has a maximum capacity of [ ] litres per day. [

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Others

24 There are also approximately 13 additional ice cream manufacturers located throughout New Zealand, including Mooloo Products Ltd, Westland Snowflake Ice Cream Ltd, and Deep South Ltd. These small manufacturers distribute their ice creams in limited geographic areas and/or specialise in premium niche market products.

Australian Manufacturers

Nestlé Australia Ltd (Nestlé)

25 Nestlé is the second largest manufacturer of ice cream in the world. Nestlé Australia Ltd is the largest manufacturer of take home ice cream in Australia, which it distributes under the "Peters" brand in all states but Western Australia. The company neither imports into nor manufactures take home ice cream in New Zealand.

Unilever (Streets)

26 Unilever is reputedly the largest ice cream manufacturer in the world. It produces a range of take home ice cream, frozen novelties and frozen desserts for distribution in Australia under the "Streets" brand. Streets' Australian ice cream manufacturing facility is located in Sydney. Streets exports twenty-one types of frozen novelties (eg "Magnum") and frozen desserts (eg "Viennetta") from Australia to New Zealand (Auckland and Christchurch). It has recently started exporting three flavours of take home ice cream (vanilla, chocolate and blueberry) to New Zealand under the "Blue Ribbon" brand, which it currently distributes on a trial basis through the Woolworths supermarket chain.

INVESTIGATION

27 Staff had available to them considerable information obtained as a result of the two previous investigations into Tip Top's notices for clearance. The current investigation involved reviewing the market definition, updating market shares, capacity figures, plant ownership details and market entry possibilities, and conducting an examination of United Dairy's motives for deciding to discontinue participation in the take home ice cream market.

28 With respect to United Dairy's motivation for exiting the market, the evidence is inconclusive. However, the agreement for sale and purchase of business assets entered into between Tip Top and United Dairy on 5 November 1996 required [

] Under these circumstances is unlikely that United Dairy had the intention of continuing with the contract manufacturing and packing agreement on a long-term basis.

29 Essentially, the parties believed that the Commission's previous decision was incorrect. A letter dated 4 November 1997 from NZCDC to Tip Top (the 4 November 1997 letter) states that "(b)oth Tip Top and NZDG thought at the beginning that the Commission had got its analysis wrong, especially the entry barriers, and that Tip Top would not be dominant if it acquired New American." Accordingly, the parties devised a two-step strategy to allow for the Commission's decision. The 4 November 1997 letter states, that "(g)iven the problems of resolving the matter promptly, the two step acquisition proposal was put in place." Specifically, they decided to seek approval for Tip

Top's acquisition of New American's manufacturing assets immediately, and, if that was approved, to re-apply a year later for the New American brand and factory lease. The 4 November 1997 letter reminds Tip Top of the compelling logic of the second leg of the strategy when it states "that a transfer of the Otahuhu lease and the brand name for take home could themselves hardly result in you becoming market dominant, yet that would be the issue under the Act." According to one ice cream manufacturer, the parties are so confident of success on their application that the independent distributors of New American ice cream were informed several weeks ago that they would no longer be distributing New American ice cream, because Tip Top would be taking over that function with its own distribution network.

30 Pursuant to the parties' arrangement (ie, sale price [ ]), United Dairy would have had little incentive to aggressively market New American take home ice cream in the past year. Indeed, it had incentive to run down the New American brand, thereby losing market share and improving the chances for success on the present clearance application. Based upon discussions with industry participants, it appears that this in fact occurred. The supermarket chains uniformly indicated that Country Foods made only a half-hearted attempt to distribute and market New American ice cream in the past year. As a result, Woolworths dropped the brand entirely and its market share declined nationally from [ ]% to [ ]%.

31 United Dairy's lack of effort in the past year was commented upon by Tip Top's managing director in a letter to NZCDC dated 31 October 1997. Mr O'Connor stated that:

> "In our opinion, the Commission will be hard to convince, and will be looking at the conduct of the parties in the marketplace. To this end we suggest that it is in NZDG's interest to ensure that New American ice cream is being seen to compete vigorously in the marketplace. Such vigour is not evident at the moment."

Despite that statement by Mr O'Connor, some industry participants consider that Tip Top was at least partially responsible for the recent decline in New American's fortunes. On several occasions during August and September of this year when New American was scheduled for promotions at supermarket chains, New American ice cream was not available in sufficient quantities or flavours, indicating that production of New American ice cream was a low priority for Tip Top.

32 As discussed above, [ ]. Not

surprisingly, then, much of the application is a rehash of arguments made in the preceding two applications. However, perhaps fortuitously for Tip Top, there has in fact been some change in market conditions in the past year. The effect of those changes on the dominance analysis is evaluated below.

THE MARKETS

33 In its consideration of Tip Top's last application for clearance, the Commission defined the relevant product markets as being the New Zealand markets for the:

- manufacture of take home ice cream; and
- wholesale supply of take home ice cream.

34 Tip Top was previously given clearance by the Commission to acquire the manufacturing assets of New American and its frozen novelty, scoop ice cream and frozen dessert business. The current application requests clearance to acquire the New American brand for use in connection with the wholesale supply of take home ice cream. Accordingly, the relevant market for the purpose of determining the present application is the New Zealand market for the wholesale supply of take home ice cream (the take home ice cream market).

35 As discussed in the Commission's previous decisions in connection with this matter, the take home ice cream market consists of one, two and five litre containers of ice cream, which are primarily sold in supermarkets. Ice cream sold in this form is consumed by customers at home. Take home ice cream is most often served as a dessert or an accompaniment to a dessert.

36 The applicant has suggested that certain frozen desserts such as Viennetta, gelato and sorbet are part of the take home ice cream market. In addition, the applicant once again argues that frozen baked desserts, pastries and cakes, custard and related products, fresh yoghurt, canned fruit and similar products, cakes and biscuits, and some confectionery products are potential substitutes for take home ice cream. Enquiries made of market participants have confirmed that those products are not considered to be close substitutes for take home ice cream by consumers and are properly excluded from the take home ice cream market.

37 The applicant also argues that take home ice cream consumed with wafer cones in the home should be included in the frozen novelties/scoop market rather than the take home ice cream market. The applicant states that since "at

least some" frozen novelties are clear substitutes for take home ice cream that the Commission must make "some allowance". Staff do not consider that the use which consumers make of ice cream once they have taken it home alters the essential product market definition in any way, and therefore no allowance has been made.

ASSESSMENT OF DOMINANCE

38 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

39 Section 3(9) of the Act states that a person is in a "dominant position" in a market if:

> ...that person as a supplier or an acquirer...of goods and services, is...in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is...in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to -
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> (a) The share of the market, the technical knowledge, the access to materials or capital of that person...:
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> (b) The extent to which that person is constrained by the conduct of competitors or potential competitors in that market:
>
> (c) The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

40 In reaching a view on whether a person is in a position to exercise a dominant influence in a market, the Commission considers the foregoing non-exhaustive factors and any other relevant matters that may be found in a particular case. Important factors to consider in this case include the constraint from existing competition, the viability of imports, entry conditions and the countervailing power of supermarkets.

41 In *Port Nelson Ltd v Commerce Commission*[4], the Court of Appeal approved the following dominance standard adopted by the High Court (McGechan J):

> ... ["dominance"] involves more than "high" market power; more than mere ability to behave "largely" independently of competitors; and more than power to effect "appreciable" changes in terms of trading. It involves a high degree of market *control*.

42 A dominance assessment for the take home ice cream market follows.

The New Zealand Market for the Wholesale Supply of Take Home Ice Cream

43 For the year ending 2 November 1997, there were sales of about $54 million in the take home ice cream market, representing approximately 29 million litres of ice cream.

Market Shares

44 According to the Commission's *Business Acquisition Guidelines*, a dominant position in a market is unlikely when, after the acquisition, the combined entity will possess:

- a market share of less than in the order of 40%; or
- a market share of less than in the order of 60% and at least one competitor will have no less than in the order of a 15% share of the relevant market.

45 If either of the foregoing situations applies, then the proposed acquisition will generally fall within a "safe harbour" and the acquisition is unlikely to lead to the acquisition or strengthening of a dominant position in the relevant market.

46 There has been some shift in market shares since the Commission's 24 September 1996 decision. At that time, Tip Top had a [ ]% share of the take home ice cream market by value (including controlled label brands manufactured by it), and New American had an [ ]% share of the take home ice cream market. For the year ending 2 November 1997, Tip Top had retained a [ ]% market share. However, whether by design or not, New American has lost market share in the take home ice cream market in the past year. As of 2 November 1997, New American had a [ ]% share, down [ ]% on its previous year's figures. Taking the take home ice cream market share

data at face value, then, the post-acquisition market share of Tip Top and New American combined would be [ ]%, rather than [ ]%.

47 Tip Top has informed the Commission that it intends to continue the New American brand. The issue arises as to whether Tip Top can revive the New American brand to its former market share levels. The supermarket chains and Tip Top's competitors believe that Tip Top will use New American as its "fighting brand". That is, it will combat the competition on price with New American, while keeping its Tip Top brand elevated as a higher priced, premium ice cream.

48 The New American brand has lost credibility in the past year. Except for the sale of existing inventories, Woolworths deleted the New American brand of take home ice cream effective 17 October 1997. It has [

] Woolworths commented that the New American brand is strong, and will continue to be so if its owners take some interest in it. As of late, there has been little evidence of interest in the New American brand. Woolworths represents [ ]% of the retail market for take home ice cream.[5]

49 A range of opinions were expressed by the other supermarket chains. [

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50 The ice cream manufacturers considered that the New American brand likely had a long-term future. [

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51 In short, market participants generally believe that Tip Top will be readily able to resuscitate the New American brand should it choose to do so. Accordingly, staff consider that the present market share of the New American brand is to some extent misleading and does not fairly reflect the true value of the brand in the market. For the purpose of determining the present application, staff adopt a market share range for New American between its present share and that of a year ago; that is, between [ ].

<u>Controlled Labels</u>

52 In addition to the market share which Tip Top has by way of its own brands of take home ice cream [ ]%, it possesses [ ]% additional share of the take

home ice cream market through its "controlled label" business. Supermarket chains contract with ice cream manufacturers to produce ice cream for labelling under one or more "controlled" labels or house brands. Take home ice cream so labelled contains no reference to the manufacturer. Examples of controlled labels include New World's "Pam's" and "Budget" brands, and Woolworth's "First Choice" and "No Frills" brands.

53 Sales of controlled label ice cream comprise [ ]% of the take home ice cream market, up from [ ]% a year ago. Tip Top, which manufactures controlled label ice cream for Foodstuffs and Progressive accounts for [ ]% while Mel-O-Rich, which manufactures controlled label ice cream for Woolworths, accounts for the remaining [ ]%.

54 As it has in its previous applications, Tip Top argues that its controlled label business should not be included in its market share. For the various reasons set out in detail in its 24 September 1996 decision, which will not be repeated herein, the Commission has previously determined that it is appropriate to include Tip Top's controlled label business in its overall market share for purposes of conducting its dominance analysis. No changes have occurred in the industry which should cause the Commission to alter from this position. If anything, the recent investigation has confirmed that the Commission's treatment of controlled label business is correct.

55 Currently, only Mel-O-Rich and Tip Top manufacture controlled label ice cream for wholesale supply to supermarkets. Woolworths, which reviews its controlled label take home ice cream contract annually, has indicated to the Commission that [

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56 Tip Top manufactures controlled label ice cream for Progressive and Foodstuffs nationally. Progressive stated that Tip Top [

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57 Foodstuffs (Auckland) stated that it was possible to switch to another controlled label manufacturer, but that the alternative manufacturer would

have to provide a good quality ice cream at a more favourable price than Tip Top. Foodstuffs (Auckland) considered that [

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58 Foodstuffs (Wellington) said that [

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59 For the reasons stated in its 24 September 1996 decision and for the further reasons stated above, staff consider that inclusion of Tip Top's controlled label business in its market share is appropriate. All manufacturers and supermarket chains consulted agreed with this approach noting the relative stability of supply contracts.

<u>Market Shares of Competitors</u>

60 The market shares of the participants in the take home ice cream market (including controlled label shares) for the past two years are as follows:

<u>Manufacturer</u>	**Year Ending 3 Nov 1996**	**Year Ending 2 Nov 1997**
Tip Top	[	
		]
Total	**100%**	**100%**

61 On a national basis, the market share of the next largest competitor to the combined entity would be Mel-O-Rich with [ ]%. Following Mel-O-Rich, Kiwi has [ ]%.

62 Talley's market share has increased from [ ]% to [ ]% in the past year which is ahead of its projections. Talley's estimates that it should be able to achieve a [ ]% market share, and has in fact done so in isolated months.

Exports

63 Tip Top argues that the [ ]% of its production which is committed for export "should not be included in its share of the New Zealand take home ice cream market." As the foregoing market share figures are based upon the dollar value of the market participants' domestic sales through the supermarket chains, Tip Top's export production has clearly not been included.

Conclusion on Market Shares

64 Whether or not Tip Top's controlled label business is included, the combined entity's post-acquisition market share does not fall within a safe harbour. The combined entity will have a [ ]% - [ ]% market share ([ ]% - [ ]% excluding Tip Top's controlled label business), and its nearest competitor Mel-O-Rich will have only a [ ]% market share ([ ]% excluding its controlled label business). Accordingly, staff do not consider that the market share situation has changed appreciably since the Commission's 24 September 1996 decision. However, the combined entity's market share is just one of several factors which must be considered before a conclusion is reached on whether the proposal will result in the acquisition or strengthening of a dominant position in the New Zealand market for the wholesale supply of take home ice cream.

Constraint by Existing Competitors

65 It is not believed that existing competition in the take home ice cream market would provide a substantial constraint on the combined entity. Existing players are quite numerous and small, individually holding no more than [ ]% of the market and collectively only [ ]% to [ ]%.

66 With the exception of Tip Top and New American, only Talley's has a national presence in the take home ice cream market. However, Talley's strength is in the Lower North Island and the South Island with only a minor presence in Auckland. It is presently operating at [ ]% of its maximum daily capacity of [ ] litres per day. As Talley's is manufacturing on a [ ] day per week schedule it could potentially increase its daily production to [ ] litres per day, operate [ ] days per week and thereby produce an additional [ ] litres per week, or [ ] million litres per year. As the total market is about 30 million litres per year, assuming that Talley's could produce and sell ice cream at its maximum capacity, it could potentially capture another [ ]% of the market on top of its existing [ ]% share for a total potential market share of nearly [ ]%.

67 Terry Kroupa, Talley's national sales manager, stated that [

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69 The other take home ice cream manufacturers are only regional in nature. Kiwi's business is concentrated in the Auckland region and Mel-O-Rich's in the Lower North Island. Only Deep South has a significant presence in the South Island. Due to distribution and promotional costs, the smaller manufacturers are unable to develop significant market shares beyond the region where their manufacturing facilities are located.

70 Whereas the small players may provide limited constraint in individual supermarkets or regions of the country, they do not provide constraint on a national basis. In the context of the discussion on constraints by market entry in the Commission's *Business Acquisitions Guidelines,* it is stated that "(t)he Commission will not consider entry which might only occur at relatively low volumes or in localised areas to represent a sufficient constraint to alleviate concerns about market dominance." Staff believe that the regionalised competition afforded by current market participants, if it exists at all, should also be discounted as providing a sufficient constraint on the combined entity to alleviate dominance concerns.

71 The regional market participants do not see Tip Top and New American as the competition. For the most part, the smaller manufacturers accept that any market share gained will be at the expense of one of the other regional participants. In the regions of the country where they do compete, Kiwi Talley's, Mel-O-Rich and Deep South compete with each other aggressively. Tip Top and New American, due to their promotional budgets and brand recognition, are considered by the other manufacturers to be in a separate class. [

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72 The smaller manufacturers would appear to place little price constraint on Tip Top and New American. With the exception of certain premium, niche ice creams such as Killinchy, the Tip Top and New American brands typically sell at a premium of 5% to 30% on the smaller manufacturers' brands, although promotions sometimes close the gap for short periods of time.

Manufacturing Capacity of Market Participants

73 While the manufacturing capacity of the combined entity is not directly at issue for purposes of this application, since the Commission's previous decision cleared the acquisition of New American's manufacturing assets, it is nonetheless of some relevance. It is relevant to the ability of competitors to increase production, acquire additional market share in the take home ice cream market and to constrain thereby the combined entity. Moreover, the existence of excess capacity is relevant to the ability of the combined entity to, for example, flood the market with low-priced, New American ice cream in order to eliminate, or reduce the competitiveness of, its rivals.

74 Amongst the main participants in the ice cream industry, there is a significant amount of unused manufacturing capacity, much of which is held by Tip Top. Several manufacturers have stated that they have the ability to increase production volume of take home ice cream by adding extra shifts, or by diverting manufacturing capacity of other ice cream products (generally scoop ice cream) to manufacture of take home ice cream.

75 The following table shows information provided by each manufacturer for the past year's average daily production volumes and the maximum capacity available to produce take home ice cream.[6] Calculated from these figures are each manufacturer's excess capacity and utilisation rates (average daily production stated as a percentage of maximum daily capacity).

Company	Average Production (litres/day)	Maximum Capacity (litres/day)	Excess Capacity (litres/day)	Utilisation Rate %
Tip Top	[			
Kiwi				
Mel-O-Rich				
Talleys				
Totals				]

76 Each manufacturer was asked to estimate its current production figures on the basis of daily production volumes, averaged over a year to account for seasonal variations. Take home ice cream production is seasonal, but not to the same extent as frozen novelties. With the exception of Tip Top, manufacturers estimate a 20 - 40% variation in production for take home ice cream between the off-season ("winter" months of March through August) and

peak season ("summer" months of September through February), whereas the variance is 50% or more with frozen novelties. In contrast, Tip Top's production figures show a [ ]% or more reduction in the off season than in the peak season. Tip Top's Auckland and Christchurch plants produce approximately [ ]% and [ ]%, respectively, of their total take home and scoop ice cream production between [ ].

77 Manufacturers were questioned about the feasibility of increasing production during the off-season and storing the surplus on-site or off-site for use in the peak season. [

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78 Due to the economics of running a plant, manufacturers typically operate full shifts, but fewer days a week during the off season. [

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79 Each manufacturer was also asked to estimate its maximum capacity, based on its ability to increase production volumes by working a 20-hour day, seven days a week, but without further capital expenditure on plant. In some instances, however, manufacturers could not achieve these stated maximum capacities in practice without capital expenditure to remove 'bottlenecks'. For example, [

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80 With respect to Tip Top, its Auckland and Christchurch maximum capacity figures are based upon [ ] hour and [ ] hour work days, respectively. Tip Top states that Auckland has [

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81 The above table is different in two main respects from the capacity table in the Commission's 31 October 1996 decision. First, Pacific Dairy is no longer listed because its plant was acquired by Kiwi. The capacity figures for Kiwi are accordingly much higher reflecting the closure of Kiwi's Tauranga plant and the substitution of the much larger manufacturing facility of Pacific Dairy in Auckland.

82 Second, New American's capacity and production figures are no longer separately listed in light of Tip Top's acquisition of its manufacturing facility.

Tip Top has stated that the addition of New American manufacturing assets to its Auckland and Christchurch plants has had [

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83 The figures in the table illustrate that Tip Top's share of total manufacturing capacity is [ ]%. The highest individual capacity of the other manufacturers is the [ ]% held by Kiwi. With respect to excess capacity, Tip Top has a [ ]% share and Kiwi has a [ ]% share. Mel-O-Rich and Talleys have [ ]% and [ ]%, respectively.

84 Tip Top argues that its export production is not relevant to the issue of excess domestic manufacturing capacity. However, based upon discussions with market participants, staff consider that export production can be readily diverted to domestic use should sufficient economic incentive arise. Indeed, most manufacturers have recently diverted much of their export production to domestic use based upon difficult trading conditions in Asian markets. Moreover, in connection with Tip Top's last clearance application, United Dairy argued vigorously that export production should be considered to be readily available for the domestic market.

Conclusion on Constraint by Existing Competitors

85 At the time of its last application, Talley's was a very new entrant to the take home ice cream market and had only acquired a [ ]% market share. In slightly over a year, Talley's has improved its market share to [ ]% and if it maintains its performance of recent months may soon achieve a [ ]% market share on a moving annual total (MAT) basis. Of course, this improvement by Talley's appears to be largely the result of the declining performance of New American. If, as anticipated, Tip Top establishes New American as a fighting brand to compete with Talley's and the other market participants on price, there is no guarantee that Talley's will continue to grow its market share to its present potential of nearly [ ]%. The most that can be said at this point is that Talley's, having access to considerable capital to expend on marketing and potential plant expansion and supplying a good quality product, with a known name and reputation, and national distribution capabilities may provide some constraint on the combined entity, particularly with respect to the New American brand.

86 There is no reason to believe that any of the other existing competitors in the take home ice cream market may properly be considered, individually or collectively, as a sufficient constraint to allay dominance concerns with respect to the post-acquisition conduct of the combined entity. The next largest competitors, Mel-O-Rich ([ ]% market share) and Kiwi ([ ]% market share), despite having been in business for more than 10 years, have shown only very limited ability to acquire market share outside of the Upper North Island and Lower North Island respectively. And, [

] In any event, the bulk of the excess manufacturing capacity in the industry is held by Tip Top, which could use it as a potent weapon against its competitors in connection with the New American brand.

87 There is no indication that the combined entity would be constrained by the threat of a competitive response by any existing market participant. Even were their market shares aggregated on a regional basis, existing market participants would not act as a significant constraint on the combined entity.

Constraint from Imports

88 As was noted by Tip Top in its application, Streets has begun importing take home ice cream from Australia. Streets began importing the first week of October and plans [

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94 In addition to Streets, Tip Top's application once again mentions Nestlé as a potential entrant to the take home ice cream market by way of imports. Staff discussed this prospect with Nestlé New Zealand Ltd's managing director, Wolfgang Reichenberger, who stated that Nestlé [

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Conclusion on Constraint from Imports

95 From discussions with Streets, it appears that [

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96 Accordingly, staff consider that entry to the take home ice cream market by way of imports is not likely to occur, be of sufficient extent, timely or sustainable so as to constrain the combined entity.

Constraint from Potential Competitors

<u>Entry Conditions</u>

97 Entry conditions, including the nature and height of any entry barriers, must be determined before the threat of new entry, which might constrain the conduct of the combined entity, can be properly evaluated. In this regard, the following conditions of entry to the take home ice cream market are identified and discussed:

- To enter the take home ice cream market on a national basis by way of new manufacture with the potential to constrain thereby the combined entity, capital expenditures of between $3 million and $5 million would likely be required. Talleys, which recently entered the market, spent [ ] on its manufacturing facility. The take home ice cream market is a mature one with low margins available. Moreover, seasonal variations make it difficult to retain staff and maintain profitability during the winter months, requiring dependence upon erratic export markets. Given the large excess manufacturing capacity in the industry, it is unlikely that another company will attempt to follow in Talley's footsteps and enter the take home ice cream market by way of a new manufacturing facility.

- New American's failed attempt at participating in the take home ice cream market by selling contract manufactured ice cream would likely discourage those who might otherwise seek to enter the market by this means. Already low margins would be squeezed even more, plus the contract manufacturer would likely favour its own production over that of its rivals as Tip Top apparently did. Rival manufacturers were several times called in at the last minute to handle supermarket promotions since New American was unable to supply the quantities or variety of ice cream required.

- Obtaining space in supermarkets for new ice cream brands is difficult. Space in freezers is finite. After controlled labels and the major brands such as Tip Top and New American are stocked, there is not much space left for other brands. As the Commission noted in Decision No 127, the combined entity could lessen the effectiveness of a new entrant by exercising "shelf power".

- Advertising and promotion costs to develop awareness of a new brand are likely to be difficult to fund from borrowing, and would be substantial for a new entrant to the take home ice cream market. Without major advertising and promotional campaigns, it is hard to get consumers to try a new product.

- Tip Top has built a reputation for a quality product which is a difficult barrier for a new entrant to the take home ice cream market to overcome.

- There are numerous independent distributors of frozen food that may be contracted to transport ice cream around the country, but it is costly.

The applicant previously calculated that transport from Auckland to Wellington adds [ ] and Auckland to Christchurch adds [ ] per two litre container of ice cream. Tip Top, by comparison, has plants in both Auckland and Christchurch from which it supplies take home ice cream to the respective islands. It should be noted, however, that Woolworths currently has, [ ], central warehousing in place such that ice cream need only be supplied into central warehouses with distribution to the individual stores left to the supermarket chains.[7]

- A new entrant might expect a competitive response to its entry by Tip Top. For instance, Tip Top might exercise its "shelf power", increase its marketing or reduce its prices.

Conclusion on Entry Conditions

98 The entry conditions to the take home ice cream market at a national level are collectively quite high, forming a fairly strong disincentive to entry to the market. New entry to the market by way of new manufacture would face the barrier of the current over-capacity in a mature market, Tip Top's strong reputation, high advertising costs and the limited freezer space available in the supermarkets. The recent experience of New American will certainly not engender confidence in potential entrants that entry to the market by contract manufacturing is likely to be financially viable. Streets will only consider entry by this means if it is able to command a premium for its product based upon its reputation.

Nestlé

99 Nestlé stated that [

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100 Based upon staff discussions with Nestlé, it is believed that potential competition from Nestlé should not be considered to pose a significant constraint on the combined entity.

<u>Streets</u>

101 As discussed above, Streets has entered the take home ice cream market in New Zealand by way of [ ] imports. [

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[ ]

102 [

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Conclusion on Constraint by Potential Entrants

103 In order to evaluate the potential for constraining market entry which would be sufficient to allay concerns of market dominance, the Commission considers whether such entry is likely and whether it would be sufficient in extent, timely and sustainable (the "*lets*" test).[8]

104 At this point in time, staff do not consider that [ ], and therefore discount it as a potential constraint on the merged entity. Staff conclude likewise with respect to [ ].

105 Application of the "*lets*" test to Streets' potential entry is somewhat more difficult at present than it would be several months from now when the product trial has been completed and the product discontinued or [ ]. However, open discussions with Streets have provided a good insight into its strategy and prospects for success.

106 Likelihood of entry is judged on the basis of whether entry to the market has a reasonable prospect of achieving a satisfactory return on the entrant's investment. [

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107 [

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108 [

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109 Staff consider that any entry by Streets to the take home ice cream market would be timely. [

] If Streets proceeds with entry, it should occur before any exercise of market power by the combined entity to the detriment of consumers.

110 If Streets decides to enter the market after the product trial has been completed, it would likely sustain that entry, although a market response by Tip Top would certainly be anticipated.

111 In short, potential entry by Streets to the take home ice cream market by means of contract manufacturing would be timely and is likely to be sustainable. However, concerns about the likelihood and extent (and nature) of entry prevent staff from concluding that potential entry by Streets is likely to provide a constraint on the business activities of the combined entity.

112 In addition, staff do not consider that potential entry by any other person by way of new manufacture or contract manufacturing would meet any branch of the "lets" test.

Constraint by Suppliers

113 The combined entity would be vertically integrated and would manufacture its own take home ice cream for wholesale supply in New Zealand. In addition, the raw materials for the manufacture of take home ice cream are readily available in New Zealand and overseas, and manufacturers pay substantially similar prices for their raw materials.

114 In short, the combined entity would not be constrained by suppliers.

Constraint by Acquirers

<u>Consumers</u>

115 The applicant submits that there are a host of potential substitute products to which consumers may turn should the combined entity attempt to exercise its market power. The alleged substitute products are: frozen baked desserts, pastries and cakes; custard and related products; fresh yoghurt; soft drinks; novelty chocolate bars; canned fruit; cakes and biscuits; and general confectionery (eg chocolate, boiled sweets, crisps).

116 Staff do not believe that in the event of a 5% increase in prices by the combined entity that consumers would switch from ice cream to any of the purported substitute products. If there were such an opportunity for substitution, then staff would have included those products as appropriate within the defined product market. Some of the identified "substitutes" are more properly considered to be "complements" to take home ice cream.

<u>Supermarkets</u>

117 Ice cream manufacturers supply 90% of their take home ice cream to supermarkets. Supermarkets do have some constraint on manufacturers' pricing. For the most part, if the supermarkets do not believe the ice cream will sell at acceptable margins, they will not purchase it. However, as there is such a large demand by consumers for the Tip Top and New American brands, supermarkets have little choice but to supply those brands for which consumers are prepared to pay a premium. Supermarkets may be able to restrict the freezer space presently allotted to Tip Top and New American should Tip Top attempt to raise prices or reduce quality or service. [

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118 Supermarkets might also be able to use controlled label contracts to constrain the combined entity in its conduct. As consumers are typically unaware of the identity of the manufacturer of controlled labels, supermarkets can plausibly threaten to contract with another manufacturer for supply. With Tip Top's

extensive capacity, the threat of the loss of controlled label business could be an effective constraint. However, whether the threat would be perceived as a real one is not clear, considering other manufacturers' limited ability to supply ice cream nationally to the supermarket chains.

119 A move to central distribution facilities by supermarket chains would enable supermarkets to constrain Tip Top by supporting smaller wholesalers without extensive distribution networks. At present, only Woolworths has central distribution facilities available for ice cream, [ ]. Staff do not believe that the other chains would have incentive to move to central warehousing for purposes of take home ice cream only.

Conclusion on Constraint by Acquirers

120 Staff conclude that, although supermarkets would provide some constraint, on balance, acquirers of take home ice cream would not be such a constraint on the exercise of market power by the combined entity so as to alleviate concerns of market dominance.

121 Any countervailing power held by supermarkets would be blunted by lack of alternative suppliers and consumer demand for the Tip Top and New American brands. [ ]

Conclusion: Market for the Wholesale Supply of Take Home Ice Cream

122 Since the Commission's 24 September 1996 decision declining to give clearance in this matter, the only significant change of circumstances in the take home ice cream industry has been the potential entry by Streets. For the reasons stated above, staff do not consider that this potential change is sufficient to allay dominance concerns at this point in time.

123 Accordingly, staff are not satisfied that the acquisition by Tip Top of the remaining assets of the New American business from United Dairy would not result, or would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the New Zealand market for the wholesale supply of take home ice cream.

RECOMMENDATION

124 Having had regard to the factors set out in section 3(9) of the Act, staff are not satisfied that the proposed acquisition would not result, or would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the New Zealand market for the wholesale supply of take home ice cream. It is recommended that, in terms of section 66(3)(b) of the Act, the Commission decline to give clearance for the proposed acquisition.

Investigator Investigator Manager