

**COMMERCE ACT 1986: BUSINESS ACQUISITION
SECTION 66: NOTICE SEEKING CLEARANCE**

Date: 29 August 2005

The Registrar
Business Acquisitions and Authorisations
Commerce Commission
P O Box 2351
WELLINGTON

Pursuant to section 66(1) of the Commerce Act 1986 notice is hereby given seeking **clearance** of a proposed business acquisition.

PART I: TRANSACTION DETAILS

1. THE BUSINESS ACQUISITION

1.1 Fonterra Co-operative Group Limited ("**Fonterra**") and Rank Group Limited ("**Rank**") have executed a Heads of Agreement dated 6 August 2005 ("**Heads of Agreement**") pursuant to which Fonterra and Rank will exchange some of their respective businesses ("**Main Transaction**"). As part of the Main Transaction Fonterra will acquire the New Zealand Dairy Foods Limited ("**NZDF**") "Anchor", "Fernleaf" and "Country Soft" branded butter and spreads business and related inventory subject to Commerce Commission ("**Commission**") clearance ("**Spreads Transaction**"), and it will acquire NZDF's unbranded butter and spreads business. Fonterra will retain the butter and spreads business owned by its subsidiary Mainland Products Limited ("**Mainland**"), and Rank will retain the spreads business of Goodman Fielder Limited ("**Goodman Fielder**").

1.2 The business acquisition for which this clearance is sought is Fonterra's acquisition of the branded butter and spreads business of NZDF.

Summary of application

1.3 The relevant market is the market for the wholesale supply of consumer yellow spreads in New Zealand ("**consumer yellow spreads market**"). Under the Spreads Transaction, there will be an aggregation of Fonterra's and NZDF's existing market shares. However, there will be no substantial lessening of competition because the consumer yellow spreads market is sufficiently constrained by the manufacture and distribution of other products competing in that market, including margarine, butter and other spreads. In addition, other market conditions, in particular the countervailing power of supermarkets and low barriers to entry, will constrain Fonterra's operations after the acquisition.

1.4 The consumer yellow spreads market is characterised by:

- (a) large international vertically integrated suppliers, selling fungible products traded internationally at transparent prices;
- (b) a range of competitors who have access to all required quantities of those products, at those international prices;
- (c) supermarkets with unique buyer power who control the access of the suppliers to the channel for sale and who are themselves (through housebrands) the second largest suppliers in the yellow spreads market. In the associated

market for the wholesale supply of town milk, one of these supermarkets, Foodstuffs Wellington, has for example exercised this countervailing power by ceasing to buy housebrand milk from the traditional suppliers, and substituted its own supply channels, including its brands;

- (d) differentiated products servicing a market which is declining overall and where in the last three years the butter segment has been declining in both volume and value terms at a faster rate than the balance of the market, while at the same time the international product input price for butter has increased substantially.

- 1.5 The acquisition for which clearance is sought is unusual in commercial terms, as the seller will remain unconstrained as a competitor in the relevant market. Rank will remain the largest supplier in the consumer yellow spreads market operating through Goodman Fielder and potentially NZDF supply channels, and with no constraints on its ability to compete in all segments of the relevant market.

2. NOTICE GIVEN BY FONTERRA

- 2.1 This notice is given by:

Fonterra Co-operative Group Limited
Private Bag 92032
AUCKLAND

Telephone: 09 374 9000
Facsimile: 09 379 8284
Attention: David Matthews, General Counsel

- 2.2 All correspondence and notice in respect of the application should be directed in the first instance to:

Russell McVeagh
Mobil on the Park
157 Lambton Quay
PO Box 10-214
WELLINGTON

Telephone: 04 499 9555
Facsimile: 04 499 9556
Attention: Pat Bowler

3. CONFIDENTIALITY

- 3.1 Confidentiality is sought in respect of all items deleted from the public copy of this application ("**confidential information**"). The items are either indicated in the public version in square brackets ("**[Confidential]**"), or contained in **Appendices 1 and 3**, the entire contents of which are confidential.

- 3.2 In respect of the confidential information, a confidentiality order is sought under section 100 of the Commerce Act 1986 ("**Act**"), and confidentiality is claimed under section 9(2)(b)(ii) of the Official Information Act 1982, on the grounds that the information is commercially sensitive and valuable information which is confidential to the participants, and disclosure of it is likely to give unfair advantage to competitors of the participants and/or unreasonably to prejudice the commercial position of the persons involved.

- 3.3 Fonterra requests that it be notified of any request made to the Commission under the Official Information Act for release of the confidential information, and that the Commission seeks its views as to whether the information remains confidential and commercially sensitive, at the time responses to such requests are being considered.

4. DETAILS OF THE PARTICIPANTS

- 4.1 Fonterra Co-operative Group Limited
Private Bag 92032
AUCKLAND

Telephone: 09 374 9000
Facsimile: 09 379 8284
Attention: David Matthews, General Counsel

- 4.2 Rank Group Limited
Level 12
32 - 13 Quay St
AUCKLAND

Telephone: 09 366 6259
Facsimile: 09 366 6263
Attention: Greg Cole, Chief Financial Officer

- 4.3 All correspondence and notices in respect of the application should be directed in the first instance to:

Russell McVeagh
Mobil on the Park
157 Lambton Quay
PO Box 10-214
WELLINGTON

Telephone: 04 499 9555
Facsimile: 04 499 9556
Attention: Pat Bowler / Sarah Keene
Email: pat.bowler@russellmcveagh.com /
sarah.keene@russellmcveagh.com

- 4.4 All correspondence and notices addressed to Rank in respect of the application should be directed in the first instance to:

Bell Gully
Vero Centre
48 Shortland Street,
AUCKLAND

Telephone: 09 916 8800
Facsimile: 09 916 8801
Attention: Phil Taylor/David Blacktop
Email: phil.taylor@bellgully.com /
david.blacktop@bellgully.com

5. INTERCONNECTED AND ASSOCIATED PARTIES

- 5.1 Fonterra is a co-operative dairy company incorporated under the Companies Act 1993 and registered under the Co-operative Companies Act 1996. Shares in Fonterra are held by approximately 12,000 supplier shareholders. The most recent corporate structure diagrams for Fonterra are attached at **Appendix 1**.
- 5.2 Fonterra operates in New Zealand through its subsidiaries, as set out in the Fonterra corporate structure chart attached at **Appendix 1**, and in Australia through subsidiaries. In particular, Fonterra operates a part of its New Zealand business through its wholly owned subsidiary Mainland.
- 5.3 Rank is a private equity investor based in Auckland. It has two operating subsidiaries Burns Philp & Company Limited ("**Burns Philp**") based in Australia (in which it has a controlling interest) and NZDF (a 100% subsidiary). Burns Philp wholly owns Goodman Fielder, which operates in various food markets in New Zealand, including the consumer yellow spreads market.

6. BENEFICIAL CROSS-INTERESTS

- 6.1 The only interests which each participant or any of its interconnected bodies corporate has in another participant are the interests and entitlements of the participants as set out in the Heads of Agreement, principally the agreement pursuant to which Rank will acquire all the shares in Fonterra's subsidiary Mainland.

7. LINKS BETWEEN PARTICIPANTS

- 7.1 Currently, the majority of butter sold by Fonterra and NZDF is manufactured, processed and packaged by Fonterra. NZDF also acquires some butter from Westland. NZDF's supply agreement with Westland will be assigned to Fonterra as part of the Spreads Transaction. NZDF then markets and arranges the final stages of distribution of butter sold at wholesale by NZDF. Goodman Fielder manufactures blends for NZDF.
- 7.2 The participants currently have the following formal or informal production, supply, licensing and distribution arrangements, which are conducted on commercial arms length terms:
- (a) **[Confidential]**
 - (b) **[Confidential]**
 - (c) **[Confidential]**
 - (d) **[Confidential]**
 - (e) **[Confidential]**

7.3 Following the Main Transaction, all the links between the participants will be those agreements on arms length commercial terms provided for in the Heads of Agreement. Principally these are:

- (a) **[Confidential]**

- (b) **[Confidential]**
 - (i) **[Confidential]**
 - (ii) **[Confidential]**
 - (iii) **[Confidential]**

- (c) **[Confidential]**

- (d) **[Confidential]**

- (e) **[Confidential]**
- (f) **[Confidential]**
- (g) **[Confidential]**

8. CROSS DIRECTORSHIPS

8.1 No directors of Fonterra hold directorships in any other companies which are involved in the consumer yellow spreads market in New Zealand.

9. PARTICIPANTS' BUSINESS ACTIVITIES

9.1 Fonterra is a vertically integrated dairy products manufacturer and marketer, operating in all dairy products markets in New Zealand and numerous other countries. It operates through two main business divisions:

- (a) *Ingredients*, which produces and internationally markets dairy commodities, such as milk powders, butter, cheese and value-added dairy ingredients. It also collects and processes milk. The ingredients business accounts for approximately two thirds of Fonterra's revenue, and operates from 25 manufacturing sites in New Zealand. It is also involved in the research and development of new value-added ingredients.

- (b) *Consumer Dairy Products*, which operates in 40 countries internationally under the name Fonterra Brands. It has 35 manufacturing sites in New Zealand, Australia, the Americas, Asia and the Middle East. Its major brands include

"Anchor" (but not currently in New Zealand), "Annum", "Anlene", "Soprole", "Brownes", "Bega", "Mainland", "Meadow Fresh" and "Western Star".

9.2 Rank is a private equity investor which owns NZDF and has a controlling interest in Burns Philp. Burns Philp owns all the shares in Goodman Fielder. NZDF and Goodman Fielder operate in the consumer yellow spreads markets.

9.3 Through these arrangements, the participants currently market consumer yellow spreads in New Zealand under the following brands:

Rank	Fonterra
Meadow Lea Logical Margarine	Dairy Smooth Blends
Meadow Lea Margarine	Mainland Southern Blends
Anchor Butter	Mainland Semi Soft
Anchor Blends	Mainland Butter
Country Soft Blends	
Choice Margarine	
Gold N Canola Margarine	
Olivani Margarine	
Sunrise Margarine	
Fernleaf Butter	
Golden Fern Butter	

9.4 As the table at **Appendix 2** shows, Rank is currently the largest participant in the consumer yellow spreads market, with **[Confidential]**% of all product sold in supermarkets and will remain the largest participant after the Spreads Transaction. Supermarket sales provide an accurate proxy for total market shares given that **[Confidential]**% of all consumer yellow spreads sales are made through supermarkets. Fonterra's share of supermarket sales of consumer yellow spreads is **[Confidential]**%. As a result of the Spreads Transaction Fonterra's share will increase to **[Confidential]**% and Rank's share will reduce to **[Confidential]**%. Housebrands will account for **[Confidential]**% (of this **[Confidential]**%, **[Confidential]**% is margarine and **[Confidential]**% is butter).

9.5 Rank (through Goodman Fielder and NZDF) and Fonterra also compete for industrial and ingredient yellow spreads, where anhydrous milk fat ("**AMF**") is a close substitute for butter. Those activities are not affected by the Spreads Transaction, except in relation to exports.

Principles of the Main Transaction

9.6 Under the Heads of Agreement, Fonterra will acquire the New Zealand dairy business assets of NZDF, with the exceptions discussed below. NZDF as a legal entity would remain a subsidiary of Rank. At the same time Rank will acquire, through the acquisition of all the shares in Mainland, the New Zealand retail dairy business assets of Fonterra, with the exceptions discussed below. Each acquisition would be conditional on the other, and completion would occur contemporaneously. As a result, those businesses would continue to operate and compete in the same markets before and after the Main Transaction, with substantially the same leadership and management teams remaining with the same brands and products.

9.7 Fonterra refers to the Heads of Agreement at **Appendix 3**, and the summary of their impact on various markets in **Appendix 4**.

Exceptions

9.8 The main exceptions to these principles are that:

- (a) Fonterra and NZDF will retain their respective cheese businesses (block, processed, grated and speciality) unchanged from their present operations. NZDF's current "Anchor" brand licence will terminate after 10 years (the "Anchor" brand licence used in relation to other dairy products will transfer to Fonterra along with all other assets of those businesses).
- (b) Fonterra will acquire NZDF's consumer yellow spreads business but will not sell its corresponding business to NZDF. However, only the branded consumer yellow spreads business is the subject of this clearance application.
- (c) NZDF will also acquire Fonterra's smallgoods and meats business, and Fonterra will acquire NZDF's dairy export business.

Counterfactual to the Main Transaction

9.9 Fonterra considers that the appropriate counterfactual to the Main Transaction is either the retention of the NZDF assets being sold by Rank (ie the status quo) or the sale of those assets by NZDF either to a private equity investor or an international trade buyer. Fonterra considers that retention of those assets by Rank is the most likely counterfactual.

Counterfactual to this application

9.10 The counterfactual to this application is determined by the Main Transaction. That is because, if clearance is not granted for this application, the Main Transaction will result in Rank retaining the current NZDF branded and Goodman Fielder consumer yellow spreads business as part of its dairy and smallgoods business.

9.11 The key elements of the Spreads Transaction, from a competition perspective, are that:

- (a) It affects only a relatively small segment of the market. For example, it does not affect the bulk volume business where Goodman Fielder is an importer and user of butter and AMF.
- (b) There is no restriction on Rank competing for the business being acquired by Fonterra either through NZDF (where the only restriction is on solicitation of former employees) or through Goodman Fielder.
- (c) Rank and Fonterra each (as a result of the Main Transaction) have national distribution networks. In Rank's case this will allow them to deliver products which compete with Fonterra's consumer yellow spreads without the need to establish a new distribution channel or relationships with supermarkets.

9.12 In any event, Rank's unbranded butter business will move to Fonterra, with the supermarket housebrands remaining as significant competitors in the market.

10. REASONS FOR THE PROPOSAL

10.1 The Main Transaction enables Fonterra to achieve two key objectives for Fonterra:

- (a) The realignment by Fonterra of the "Anchor" brand by reducing licence rights held by others in New Zealand. This would (especially in respect of milk) allow Fonterra to realign the "Anchor" positioning in New Zealand with the way the

brand is applied in Asian, Middle Eastern, Russian, UK and other international markets and would avoid the incongruous situation where New Zealand's main international marketing company does not own its international brands at home.

- (b) The acquisition by Fonterra of the NZDF yoghurt business, including the "Fresh'n'Fruity" brand will provide Fonterra with key yoghurt and manufacturing technology which it does not currently have. In addition, the "Fresh'n'Fruity" brand would increase Fonterra's competitiveness in Australia (and potentially elsewhere offshore).

10.2 The Spreads Transaction provides an opportunity for Fonterra to further realign Fonterra's New Zealand and international brand portfolio by regaining control of the "Anchor" brand in New Zealand, when used with butter.

PART II: IDENTIFICATION OF MARKETS AFFECTED

11. HORIZONTAL AGGREGATION

Market definition

Product dimension

11.1 The only products which are sold by Rank and Fonterra and their respective subsidiaries, which are affected by the acquisition contemplated by this application are margarine, butter (including AMF) and blends of the two. The Commission has considered the definition of the relevant market for margarine, butter and their blends on a number of occasions. In all cases it has concluded that they are part of a market for consumer yellow spreads:

(a) *Fielder Gillespie Davis Ltd and Goodman Group Limited*

The Office of the Examiner of Commercial Practice concluded, in its decision dated 3 March 1986, in relation to the takeover of Goodman Group Limited by Fielder Gillespie Davis Ltd that butter and margarine were "directly substitutable"¹ and consequently were part of the "yellow table spreads market".

(b) *Aspak Foods Limited/Abels Division and Unilever New Zealand Limited (12 October 1995)*

In the staff report into the clearance application by Aspak Foods Limited to acquire the industrial fats and oils business of the Abels Division of Unilever New Zealand Limited the Commission's investigation team considered the markets for the manufacture and distribution of industrial white and yellow fats. As part of their investigation the Commission staff found that butter and margarine were substitutes and concluded:

On the basis of our investigations, we consider that butter and industrial shortening products may be close substitutes in certain applications, and therefore would act as a constraint on the pricing of margarine.²

(c) *Mainland Products Limited/Kiwi Co-operative Dairies Ltd (15 October 1996)*

In the staff report into the clearance application by Mainland Products Limited to acquire assets and subsidiaries of Kiwi Co-operative Dairies Ltd the Commission's investigation team considered the markets for the manufacture and distribution of various dairy products. In relation to butter the Commission's staff noted that the Commission previous approach was to define the market as a market for the wholesale supply of retail-sector yellow table fats and concluded:

Due to the close substitutability of butter and margarine, butter is considered to be part of a larger market comprising yellow table fats.³

¹ Paragraph 174.

² Paragraph 23.

³ Paragraph 56.

(d) *MergeCo*

As part of the *MergeCo* Draft Determination (27 August 1999), the Commission considered whether butter was part of a wider consumer spreads market. The Commission examined evidence from the United States and evidence from New Zealand retailers that butter and margarine are close substitutes. The Commission concluded that butter was part of a wider market for consumer spreads.⁴ The Commission also noted that as margarine is commonly imported from Australia the retail price of butter will be constrained by the price of margarine, which will in turn be constrained by the supply price of Australian margarine.⁵ The Commission stated in *MergeCo* that:⁶

The proposed merger will remove the existing competition between dairy co-operatives to supply butter to the domestic market - all butter will be sourced from NewCo. However, competition from other products, principally margarine, will be unaffected.

...

The Commission concludes that the potential and actual constraints by competition from substitute products following the proposed merger are sufficient to satisfy the Commission that NewCo would not, and would not be likely to, acquire or strengthen a dominant position in the market for the manufacture and wholesale supply of consumer spreads in New Zealand.

(e) *Burns Philp and Goodman Fielder*

More recently in relation to the Burns Philp's acquisition of Goodman Fielder ("**Burns Philp**"), the Commission, in its decision (Number 487, 21 February 2003), once again considered the relevant market. It stated that:

Technically the two are obviously close substitutes. There are substantial sales of butter/margarine mixes. When two products are so closely similar they can be mixed together and utilised for the essentially the same function as the original, it seems unlikely that any of the three would not be technical substitutes for each other.⁷

The Commission once again adopted the market definition of a consumer yellow spreads market (although it noted that it was not required to adopt a more conservative approach because of the particular circumstances).⁸

- 11.2 In their day-to-day operations, the parties consider consumer yellow spreads to comprise the relevant product market, with a chain of substitution operating as between butter and blends, and as between blends and margarine. It also accords with commercial commonsense and reflects the way other competitors in the market, and the grocery trade, view the area of competition. In addition, it reflects the way in which supermarket scan data is reported to the industry.

Demand-side considerations

- 11.3 From a consumer's perspective the key factors, other than price, influencing consumer choice tend to be taste, convenience (eg "spreadability") and general health considerations.

⁴ Paragraph 202.

⁵ Paragraph 390.

⁶ Paragraphs 391 and 394.

⁷ Paragraph 53, footnote 7.

⁸ Paragraph 54.

- 11.4 Accordingly, from the demand-side, consumers in general are not concerned with technical differences in product nomenclature, composition or method of manufacture, and make purchases largely by reference to perceived product attributes such as health, taste and convenience. Industry practice, based on consumer behaviour, is to view the many different products and brands within the yellow spreads category as a continuum, with all products answering to different consumer needs or preferences to a greater or lesser extent.
- 11.5 Generally, the greater the dairy fat content, the more butter-like the product is perceived to be. For example, some of the more recent yellow spreads to be launched are the products described as "spreadable" and sold under the brands associated with butter. In the production of these products, buttermilk (which is a by-product of butter production, and which does not comprise butter fat) is often added in order to enhance the "butter" taste. This, together with the butter fat content, gives a certain buttery taste. The vegetable oil softens the butter enabling it to be spread more easily.
- 11.6 The substitution between butter, blends and margarine is apparent in:
- (a) the approach consistently taken by producers and purchasers (who are predominantly the supermarkets) in their buying habits. Within each supermarket chain, a single buyer tends to be responsible for buying the full range of yellow spreads products offered by the supermarket and, in the parties' experience, will regard yellow spreads as one market. This approach is reflected in the way in which yellow spreads products are promoted and displayed to consumers within stores: all yellow spreads products are displayed as a series of products in chilled cabinets;
 - (b) the manner in which margarine is advertised, for example the recent "Meadow Lea" advertisements, electronic copies of which are provided with this application, which directly compare margarine to butter; and
 - (c) as described in paragraph 16.26 below, customers switching away from butter to margarine and spreads, which has led to the declining share that butter represents of the consumer yellow spreads market.
- 11.7 Manufacturers have attempted to counteract the overall market decline (over the past three years, the yellow spreads market has declined in (retail) real value terms by around **[Confidential]**%, by approximately **[\$[Confidential]]**), by responding to changing consumer preferences through the introduction of new products in particular, blended spreads and margarine. This has contributed to the blurring of any historic boundaries between product categories. For example:
- (a) Goodman Fielder is currently promoting its product "Butterlea" (which is a spreadable blend of butter and oil) offering the taste of butter and the spreadability of a blend. It includes "butter" in its name and is promoted on the basis that it is impossible to tell it apart from butter in terms of taste (see advertisements provided with this application).
 - (b) "Olivio" spread, which is produced by Unilever, is also a relatively recent market entrant, which is a reduced fat olive oil and vegetable oil spread, positioned as a good tasting healthy spread.
 - (c) "I Can't Believe It's Not Butter", which is produced by Unilever, is a reduced fat vegetable oil spread with butter flavour, positioned as a buttery spread for families.
 - (d) "Flora Pro-Activ", which is produced by Unilever, is a low fat spread with vegetable oil sterol to reduce cholesterol.

- 11.8 In all cases, consumers will have a range of products within the yellow spreads category available to them which will meet their criteria.

Supply-side considerations

- 11.9 From a supply-side, there is also substitutability across the range of yellow spreads products:

- (a) Yellow spreads consumer products are produced either by the "butter churn" (or "Fritz") technology or the Scraped Surface Heat Exchange ("**SSHE**") (or "Amix") technique (well known brands include Perfector, Schroeder, Cherry Burrell, and Votator), both of which are simple processes, not relying on intellectual property rights. The "butter churn" process can be used for butter and spreads. The SSHE technique can produce margarines, butter and spreads. Fonterra uses both types of plant interchangeably to produce butter, both for retail and commodity markets. The SSHE technique is particularly versatile, in that it permits operators to add oils and fats to the process with ease. Thus, the same technology is used to produce margarine, blends and butter, with higher pressure rated SSHE machinery required to make solid pats of butter. In New Zealand, Goodman Fielder ("Meadow Lea" plant) and Bakels (Mt Maunganui plant) are understood to operate SSHE machinery. In Australia there are numerous alternatives operating this technology, including Murray Goulburn and Unilever. The ingredients for the different forms of yellow spreads are readily obtainable in abundant supply, so that this is not a constraint on manufacturers varying the composition of products within the yellow spreads market. Any supplier active in the yellow spreads market will also have ready access to distribution lines for any other products launched.
- (b) In addition, suppliers in the market can and do obtain supply from other manufacturers, for example, Mainland's "Southern Blend" was originally produced by Goodman Fielder under contract (and is now manufactured by Tip Top, [**Confidential**]).
- (c) There are no brand constraints, as brands and brand reputation can be easily transferred to products of different composition. The supermarket chains effectively determine the profile and success of external brands and can easily support the transfer of brands across other products to enhance competition, or the emergence of new brands. In addition, they are able to use their own-label brands to maximise supply-side substitutability.

Product Differentiation

- 11.10 As noted above, there is some differentiation of products in the consumer yellow spreads market, with the following segments used by Fonterra in its internal market analysis and reporting:

- (a) standard margarine;
- (b) low fat margarine;
- (c) low cholesterol margarine;
- (d) blends;
- (e) standard butter;
- (f) non-standard butter;

(g) spreadable butter.

11.11 The products in the market are also differentiated by source of manufacturing material, such as soya, olive oil or avocado, as well as branding, including housebrands.

11.12 In *Burns Philp* the Commission stated:

Burns Philp has proposed, and the Commission accepts, that butter and margarine are differentiated by product type and by brand. Margarine is soft and easily spread vis a vis chilled butter which requires to be softened by heat. That has led to the development of spreadable butters and butter-margarine mixes. Butter is differentiated by its potential use as a baking ingredient, that is by its taste. Olive oil and avocado spreads are differentiated on the basis of apparent healthiness. House brands are differentiated from proprietary brands. Olive and Avocado based margarines are 10 - 15% higher priced than are margarines manufactured from soya or more traditional oil bases.⁹

11.13 In addition, the Commission noted:

Advertising is used to create consumer yellow spreads brand awareness. Successful differentiation may create an element of market power because it helps to justify the higher price of a product (for example, the price premium olive oil based margarines and mixes). However, **supermarket operators report very little brand loyalty for butter, with purchasing decisions usually made on price alone.**¹⁰ (emphasis added)

11.14 Notwithstanding that degree of differentiation, when defining the market, the Commission concluded:

Consumer yellow spreads products are differentiated to a degree. However, the Commission considers that the products are not so differentiated as to cast doubt on there being well-defined markets for consumer yellow spreads.¹¹

Functional Dimension

11.15 The relevant market operates at the wholesale level, between manufacturers and retailers. Approximately **[Confidential]**% of consumer yellow spreads are sold in major supermarkets, with the balance sold directly into the convenience channel (eg small supermarkets, corner dairies, service stations) and to the food service channel (eg restaurants, hotels, cafés) variously either direct or via distributors. Fonterra estimates that such sales would comprise approximately **[Confidential]**% of the market.

11.16 The major supermarkets in New Zealand are highly concentrated into two chains. Those entities constitute powerful buyers of grocery items.

Geographic Dimension

11.17 The geographic market is New Zealand, given the national purchasing regimes of the major supermarkets. The supermarkets also have suppliers outside New Zealand (mainly Australia).

Market definition conclusion

11.18 In light of the Commission's previous decisions and the trend towards a more integrated chain of substitution as new and improved blends are developed and rolled out by manufacturers, Fonterra adopts a market definition of "the market for the wholesale supply of consumer yellow spreads in New Zealand".

⁹ Paragraph 102.

¹⁰ Paragraph 92.

¹¹ Paragraph 58.

Horizontal aggregation

- 11.19 Rank is currently the largest participant in the consumer yellow spreads market and will remain so, although this will reduce from **[Confidential]**% to **[Confidential]**% and Fonterra will increase from **[Confidential]**% to **[Confidential]**%.
- 11.20 Private label, or "housebrand" contracts currently represent **[Confidential]**% of the consumer yellow spreads market. As part of the Main Transaction, Fonterra will honour NZDF's existing housebrand butters contracts, until their termination. This is unconditional and is not subject to this clearance application. Fonterra does not consider that this will have any material effect on competition in the market. Fonterra does not consider that it is appropriate to amalgamate housebrand contracts with Fonterra's own supply for a number of reasons. In particular:
- (a) the current housebrand supply contracts are essentially standing contracts, rolled over on price terms renegotiated each quarter; and
 - (b) due to the competitive international price for butter, and the number of competing suppliers, at the end of that period, Rank (through NZDF or Goodman Fielder), Westland, or any other participant in the New Zealand or Australian consumer spreads markets, could equally tender for, and win the housebrand contract tender at competitive rates.
- 11.21 The supermarkets constantly review their purchases of consumer yellow spreads and require contract prices to be submitted on a regular basis and award the housebrands to different suppliers for different periods. The result is that the contracts effectively offer no assurance that they will continue for any longer than the current pricing period. Typically the pricing period is three months so that in effect they are three month contracts. The participants in the market are now aware that the volume purchased by supermarkets under the butter contracts being assigned to Fonterra will become available at their expiration.
- 11.22 There is no restriction under the Main Transaction or the Spreads Transaction on NZDF competing in that manner at that time, although the NZDF Dairy Products Agreement will terminate upon the Spreads Agreement becoming unconditional. From that time, NZDF will need to acquire butter from other suppliers, should it wish to do so. There are ready supplies of butter from imports and Westland, as described in paragraphs 16.29 to 16.42.

12. PRODUCT DIFFERENTIATION

- 12.1 In paragraphs 11.10 to 11.14 above, the application describes the Commission's conclusions on product differentiation in the consumer yellow spreads market. In summary, while there is some differentiation of products in the consumer yellow spreads market, the Commission has found that the level of differentiation is insufficient to affect market definition.

13. DIFFERENTIATION CHARACTERISTICS

- 13.1 At the two ends of the consumer yellow spreads spectrum, margarine emphasises softness and butter emphasises taste. Although butter and margarine are often used for the same purposes, their manufacturing processes and cost bases can be different. This market differentiation also reflects end customers perceptions of the products. For example, consumers are becoming more focussed on what they perceive as the health aspects of their food products, as well as taste. Producers of newer products such as olive oil based margarine attempt to emphasise this, at the expense of butter.
- 13.2 As noted by the Commission in *Burns Philp*, a key differentiation for margarine is "spreadability". Butter producers have minimised this competitive advantage by developing "spreadable butter". Spreadable butter is basic butter with the components that cause butter to be difficult to spread at low temperatures removed during manufacture.
- 13.3 As described in **Appendix 5**, the process used to make butter may also be used to produce AMF. The main difference between AMF and butter is the greater proportion of milk fat in AMF. AMF is regarded as the commercial butter equivalent and its production is primarily used for food processing applications, such as bakery and ice-cream and for confectionary manufacture. Internationally, AMF is widely used in making recombined milk.
- 13.4 Consumer butter is produced in salted or unsalted varieties, in 250g or 500g (most commonly 500g) portions, and presented wrapped or in a rigid plastic tub.
- 13.5 "Spreadable butter" differs from "butter blends", such as "Mainland Semi-soft" or "Anchor Country Soft", only in its manufacturing process. The uses are identical. Butter blends are "fat mixes" (blends of milk fat and vegetable oil, manufactured from cream). Fat mixes are also used as ingredients in bakery, confectionary and margarine manufacture.
- 13.6 As noted in paragraphs 11.12 to 11.14 above, the Commission has consistently found that while there is a degree of differentiation between the different products within the consumer yellow spreads market, this is not to such a degree as to conclude that the products at each end of the spectrum are in separate markets.

14. VERTICAL INTEGRATION

- 14.1 Fonterra manufactures butter at several sites throughout New Zealand. Approximately **[Confidential]** metric tonnes of this butter is sold in New Zealand. Those New Zealand sales are through three principal arrangements, namely the NZDF Dairy Products Agreement, the transfer of butter from Fonterra's Ingredients division to Mainland and the subsequent wholesale supply of those spreads by Mainland, and sale through Fonterra Ingredients to other industrial and domestic consumers.
- 14.2 The butter intended for sale in New Zealand is all packed by Fonterra Ingredients at various plants in New Zealand. The packaging is carried out to meet the branding requirements of NZDF under the NZDF Dairy Products Agreement, or the marketing requirements of Mainland, respectively. Both NZDF and Mainland sell to their customers in accordance with those customers' branding requirements (in the case of major supermarkets), the requirements of other wholesalers, and their own consumer brands.
- 14.3 Goodman Fielder also manufactures blended butter/margarine products for NZDF under the "Anchor Spreadable" and "Country Soft" brands. Fonterra sells butter to Goodman Fielder for use in its blended butter/margarine products. As noted at paragraphs 11.9(b)

above, Goodman Fielder formerly manufactured blends for Mainland, but these are now manufactured by Tip Top. Mainland also purchases small quantities of Meadow Lea margarine for supply to foodservice customers, at its customers' request.

15. PREVIOUS NOTIFICATIONS TO THE COMMISSION

15.1 Fonterra and Rank have been involved in the following acquisitions as applicant or target, notified to the Commission in the last three years:

Dec'n No	Date	Applicant	Target	Determination	End Result
454	14/02/2002	Mainland Products Ltd	Southern Fresh Milk Company Ltd	Cleared	Proceeded
459	22/03/2002	National Foods Ltd	New Zealand Dairy Foods Ltd	Declined	Did not proceed
459A	26/09/2002	National Foods Ltd	New Zealand Dairy Foods Ltd	Parties not associated	Did not proceed
462	29/04/2002	Anchor Investments Ltd	Grated Cheese Company Ltd	Cleared	Proceeded
487	21/02/2003	Burns Philp	Goodman Fielder	Cleared	Proceeded
542	09/12/2004	Fonterra	National Foods Ltd	Cleared	Did not proceed

15.2 In addition, Fonterra is a party to the Commission's determinations under the Dairy Industry Restructuring Act 2001, copies of which are located at <http://www.comcom.govt.nz/dairy/decisions.cfm>.

15.3 Fonterra has not undertaken any other acquisition of assets of a business or shares in any markets material to the Commission's present investigation in the last three years.

PART III: CONSTRAINTS ON MARKET POWER BY EXISTING COMPETITION

16. EXISTING COMPETITORS

Summary of competitive conditions in the market

- 16.1 Fonterra is currently constrained in the consumer yellow spreads market and will remain constrained by the existing competitors subsequent to the acquisition contemplated by this application. The consumer yellow spreads market is intensely competitive and none of the factors that generate that intensity of competition will be altered as a result of Fonterra acquiring NZDF's branded consumer yellow spreads business. These factors are:
- (a) **The market is mature:** The consumer yellow spreads market is a mature market with little volume growth.
 - (b) **There are strong existing competitors:** The current market leaders are Rank (both Goodman Fielder and potentially NZDF), Unilever and housebrands. Those competitors will remain in the market after the Spreads Transaction and their competitive position will not be compromised.
 - (c) **Supermarkets compete aggressively in the market through their housebrands:** The most important influence on current market dynamics is the substantial constraint imposed by supermarkets' housebrands, which, combined, represent [Confidential]% of the consumer yellow spreads market – a larger share of the market than all but one existing competitor (Rank). Housebrands have been a feature of the market for over a decade.
 - (d) **Supermarkets exercise countervailing market power:** The supermarket chains provide countervailing power in the market. They treat consumer yellow spreads as one of their core promoted products used to convey the value available from their respective supermarkets. The market is subject to continuous pressure from price tendering. The two main supermarkets continuously test the suppliers' prices through tender rounds for the supply of consumer yellow spreads under their own brands.
 - (e) **Supermarket competition is set to intensify:** Woolworths Limited (“**Woolworths Australia**”) announced on 22 May 2005 that it had entered into an agreement with Foodland Associated Limited (“**Foodland**”) and Metcash Trading Limited (“**Metcash**”) under which Woolworths has agreed to acquire Foodland's New Zealand business and selected Australian sites for a total value of approximately A\$2.5 billion following a demerger of those businesses by Foodland.¹² This is expected to further increase the competitiveness of the consumer yellow spreads market as Woolworths Australia has a long-standing supply relationship with significant Australian suppliers. Woolworths Australia could therefore have easy options of introducing brands sold by those suppliers. Foodstuffs and Woolworths will both seek concessions from suppliers to enable them to compete more strongly at the retail level.
 - (f) **There are no barriers to entry or barriers to expansion:** In addition to the growth of supermarket housebrands, there have been several startup new entrants which have had no difficulty sourcing margarine and butter from manufacturers and developing both distribution and marketing operations.

¹² Available at: <http://www.woolworthslimited.com.au>

Fonterra itself facilitates new entrants, with Fonterra Ingredients, for example, selling butter to Dairymaid, in competition with its own sales through Mainland.

- (g) **Consumers are highly price sensitive:** Participants strive to differentiate their products but, with some exceptions, the consumer does not place much emphasis on this, and is very price sensitive. This is demonstrated by the conclusion of the supermarkets referred to at paragraph 11.13.

Existing competitors

- 16.2 There are a number of extremely large well-resourced competitors in the consumer yellow spreads market.

Goodman Fielder

- 16.3 Goodman Fielder is an Australian-based food company and is wholly owned by Burns Philp, itself majority owned by Rank. Goodman Fielder is a major producer of consumer yellow spreads in New Zealand. Its brands include "Meadow Lea", "Sunrise", "Olivani", and "Gold N Canola". In addition:

- (a) it manufactures and supplies Foodstuffs's housebranded margarines. These housebrands are manufactured in Auckland; and
- (b) it manufactures and supplies dairy blends for the NZDF business under the "Anchor Spreadable" and "Country Soft" brands.

- 16.4 Goodman Fielder manufactures margarine in both Australia and New Zealand. In addition to yellow spreads, Goodman Fielder's other main activities are the manufacture and supply of:

- (a) bread and baked confectionary in which its largest brands are "Quality Bakers", "Vogels", "Freya's" and "Ernst Adams";
- (b) salty snacks, in which its main brand is Bluebird;
- (c) cereals and nutritious snacks, in which its largest brand is Uncle Tobys; and
- (d) bakery ingredients for commercial and home baking with its two major brands being "Champion" and "Edmonds".

- 16.5 Its total New Zealand turnover is approximately \$NZ600 million, while its Australian turnover is approximately A\$900 million.

- 16.6 It currently has **[Confidential]**% of the yellow spreads market in New Zealand and supplies a further **[Confidential]**% of the yellow spreads market by way of housebrands for Foodstuffs.

Unilever

- 16.7 Unilever plc, which is an international public company based in London and Rotterdam and is one of the largest fast moving consumer goods companies in the world. Unilever operates in 150 countries and its global turnover in the last financial year was US\$48.4 billion.

- 16.8 Unilever's yellow spreads business accounts for 12% of its global business. Its most significant brand is "Flora" margarine, which is used internationally as Unilever's flagship brand. "Flora" is recognised as driving price in the margarine segment of the consumer

yellow spreads market. Unilever also supplies "Olivio" and "I Can't Believe it's Not Butter". Unilever produces its yellow spreads at its Sydney production plant and imports that production into New Zealand.

- 16.9 It currently has **[Confidential]**% of the yellow spreads market in New Zealand.

NZDF

- 16.10 As noted above, there is no restriction under the Main Transaction or the Spreads Transaction on NZDF competing in the yellow spreads market. NZDF will retain a national distribution infrastructure and will maintain its relationships with the supermarkets. There is no restraint of trade from the sale of the NZDF butter business to Fonterra. Accordingly, there are no commercial barriers to NZDF remaining as a competitive constraint in this market either directly, or indirectly via the threat of its entry.

- 16.11 While NZDF will no longer benefit from the NZDF Dairy Products Agreement, NZDF will be able to acquire yellow spreads from other suppliers, should it wish to do so. There are ready supplies of margarine and butter available from imports and from Westland as described in paragraphs 16.29 to 16.42.

Foodstuffs and Progressive

- 16.12 The role of the supermarkets is described at paragraph 16.19 below.

Universal Foods

- 16.13 Universal Foods which has been present in the market for the last 5 years, in which time it has grown rapidly. Universal Foods procures its butter from Westland and distributes that butter under its own "Classic Farm" brand, with its principle customer being Foodstuffs in the lower North Island.

Westland

- 16.14 Westland which produces salted and unsalted butter in 250g and 500g portions for retail under the "Westgold" brand, salted and unsalted creamery and lactic butter in 25kg and 454gm portions for the foodservice industry, under the "Westpro" brand, and AMF. In addition it produces butter under brands owned by other suppliers, such as National Foods and Universal and NZDF brands. From its manufacturing operation in the South Island Westland sells its product into the foodservice and retail trade, primarily in the South Island.

- 16.15 Westland currently produces **[Confidential]** metric tonnes of butter but Fonterra believes supplies only **[Confidential]** metric tonnes in the domestic market. This provides significant potential for Westland to divert exported butter into the yellow spreads market if prices in this market were to rise. As the Commission has recognised in previous decisions, the ability for suppliers to divert exports to the New Zealand market constrains the domestic price of products.¹³

¹³ See, for example, *Sanford Limited and Simunovich Fisheries Limited*, 26 January 2005 (Decision 544) paragraphs 84-87, *Fletcher Challenge Forests Limited and Central North Island Forestry Partnership*, 14 August 2002, (Decision 467) paragraph 261, *Carter Holt Harvey Limited and Central North Island Forestry Partnership*, 5 July 2001 (Decision 426) paragraphs 132-138, and *New Zealand Seafood Investments Limited and Basuto Investments Limited*, 23 March 2000 (Decision 388) paragraph 145-149.

Dairymaid

- 16.16 Dairymaid (which was originally supplied in New Zealand by Fonterra, but is understood to be currently supplied by Westland) distributes butter primarily to Pak N Save in Wellington. Dairymaid entered the market in around mid-2000, and is understood to have recently added a cheese production line to its operation.

Bakels Edible Oils

- 16.17 NZ Bakels manufacture and distribute a wide range of bakery ingredients, and the applicant believes sells some consumer yellow spreads into New Zealand. NZ Bakels is a member of the The Bakels Group. The Bakels Group is truly global represented on all continents through its own manufacturing companies and selected agents. Bakels products are available to the bakery and confectionery industries in more than 120 countries.

Peerless

- 16.18 Peerless is an industrial producer of margarine. Peerless manufactures "Tablelands" as its branded margarine. It currently supplies the housebrand margarine for Progressive ([Confidential])% of the consumer yellow spreads market).

Role of Supermarkets

- 16.19 The supermarkets are:

- (a) Progressive Enterprises Ltd ("**Progressive**"), which is currently owned by Foodland, until the demerger described in paragraph 16.1(d) is implemented. Progressive operates supermarkets under the "Woolworths", "Big Fresh", "Price Chopper", "Foodtown", "Countdown" and "Supervalu" names and has a [Confidential]% demand-side market share in the consumer yellow spreads market.

Progressive markets housebrand products under the brands "Basic" and "Signature Range". These ranges include milk, cream and cheese.

Progressive's housebrand margarines are supplied by Peerless Foods Limited and its housebrand butter is provided by NZDF.

- (b) "**Foodstuffs**", which consists of three co-operative companies based in Auckland, Wellington and the South Island operating under the names "New World", "Pak 'N Save" and "Four Square". Foodstuffs has a [Confidential]% demand-side market share in the consumer yellow spreads market.

Foodstuffs' housebrand is "Pam's", in which it is currently investing significant promotional expenditure, including the Jamie Oliver series of endorsements. The "Pam's" product range already includes milk, butter, cheese, and other cultured dairy products such as cottage cheese, cream cheese, sour cream, including flavoured and 'lite' versions of those products. It also has a variety of ice cream products in the "Pam's" range.

Foodstuffs LNI also owns the Kapiti Fine Foods Limited, producing a range of high-value cheeses and ice creams under the Kapiti brand, and a raw milk processing facility, producing milk and cream under the "Pam's" and "Farmgate" brands. "Farmgate" was launched in March 2004 as a competing dairy brand, rather than a housebrand, with newspaper, radio and television advertising to support the launch. Foodstuffs LNI is also marketing this brand to the convenience and food service channels.

Foodstuffs housebrand margarine is supplied by Goodman Fielder and its housebrand butter by Dairymaid and NZDF.

16.20 In *Burns Philp* the Commission considered the countervailing power of the two supermarket chains in the market for consumer yellow spreads.

16.21 The Commission noted in that decision that, on the basis of its market inquiries (paragraph 124):

[a]ll persons spoken to during the Commission's investigation of the proposed merger affirmed the very high countervailing power of the two major supermarket chains in the ... market[.]

and concluded that (paragraph 125):

supermarkets will be able to exert a large degree of countervailing power against the ability of the merged entity to raise prices.

16.22 This was also the approach taken by the Commission in Decision 529 (Colgate-Palmolive Company) where the Commission said (paragraph 208):

Industry participants indicated that the two major supermarket chains have a significant amount of countervailing power in the fabric softener market, and the Commission agrees. This arises from the factors listed:

- At least 95% of fabric softener is sold in the stores of the two major supermarket chains.
- Generally, supermarkets choose which products they will stock and the shelf space and positioning of the products (which affects sales of the relevant products). Within each supermarket's promotional programme, the individual supermarket chooses which product ranges it will promote and the pricing and promotional regimes for the relevant products.
- ...
- Foodstuffs sell fabric softener in its premium ("Pam's") and generic ("Budget") house brands.
- ...
- [H]ouse brands are used by supermarket chains throughout the world to keep downward pressure on prices of branded players.
- ...
- Supermarkets indicated that they may also support a new entrant as a price fighter if the combined entity were to increase prices by 5-10% and/or decrease the quality of its product. Supermarkets have done this in the past.
- ...

The Commission concludes that supermarkets will be able to exert a *significant* degree of countervailing power against the ability of the *combined* entity to raise prices.¹⁴

16.23 Furthermore, in the Decision 542 (Fonterra/National Foods) the Commission stated that the supermarkets have considerable countervailing power and concluded that even if post-merger it was reduced the supermarkets would still have sufficient countervailing power to constrain the merged entity.¹⁵

¹⁴ Paragraph 209.

¹⁵ Paragraphs 153 - 154.

- 16.24 Fonterra considers that these factors apply equally to the consumer yellow spreads market:
- (a) A large proportion (**[Confidential]**%) of consumer yellow spreads sales are made via supermarkets. This means supermarkets control the key distribution channel for suppliers and, hence, means that suppliers are reliant on continued support from supermarkets in order to generate sales and market share;
 - (b) Consumers are highly price sensitive, with the result that the switching costs of supermarkets as between competing consumer yellow spreads are non-existent;
 - (c) Both Foodstuffs and Progressive have very strong housebrand products and, together, they represent **[Confidential]**% of the consumer yellow spreads market. The supermarkets use these brands to keep downward pressure on the price of branded products; and
 - (d) Supermarkets have supported competing entry into the market in the past, for example, Dairymaid and Peerless.
- 16.25 Furthermore, the supermarkets have every incentive to exercise their countervailing power. While the supermarkets work with suppliers who innovate and invest in product development and advertising to maintain consumer interest in the product category, multiple suppliers and brands increase a supermarket's costs without increasing turnover (particularly given the static nature of the consumer yellow spreads market).

Consumers are price-sensitive

- 16.26 As explained in the market definition section above, consumers are highly price sensitive and switch between all yellow spreads products. Competition has increased in the market although the size of the market has not increased. Increased competition has resulted in:
- (a) butter being at the lower value end of the consumer yellow spreads market; and
 - (b) butter's relative share of that market reducing substantially since 2002 as the following shows.
- 16.27 Growth in low fat and low cholesterol margarine segments and spreadable butter offerings driven by convenience has been compensated by reduction in volume in butter:

[Confidential]

No barriers to expansion in the market

- 16.28 Participants in the consumer yellow spreads market include very large firms, with the ability and capacity to expand their supply in the market in accordance with demand through increasing production (for the reasons outlined in section 17) or imports. Unilever and Goodman Fielder produce and sell very large quantities of blends and margarine worldwide.

Imports

- 16.29 There are no significant barriers to importing consumer yellow spreads. A significant proportion of the margarine sold in New Zealand is produced in Australia and exported to New Zealand:
- (a) Unilever currently imports all of its margarine products;
 - (b) Goodman Fielder manufactures most of its margarine in New Zealand but imports some from Australia; and
 - (c) Peerless Foods imports, from its Melbourne plant, the margarine it supplies to Progressive.
- 16.30 The production capacity of margarine producers in Australia is substantial. The exports to New Zealand represent only a small proportion of the productive capacity.
- 16.31 The production capacity of margarine producers outside Australia is also very large.
- 16.32 Butter is also an internationally traded commodity, and both the major butter manufacturers in New Zealand, Fonterra and Westland, are also butter exporters. Consumer yellow spreads can be stored for reasonably long periods of time, for example, while butter is usually sold within 9-10 months of production, from a food safety perspective it can be sold at any time within 2-3 years of production, provided it has been kept properly stored under frozen conditions. There are no other impediments to opportunistic buying of product on the international markets.
- 16.33 Fonterra experiences competition from imports on a regular basis, as customers constantly monitor import prices and require Fonterra to match them. Even when it does so, some customers import in order to keep channels open. For example, in relation to purchases of bulk product, both Goodman Fielder and Bakels have recently imported consignments of AMF from Ireland. They have advised Fonterra of this and explained that the reason was to maintain price pressure and establish working relationships with offshore suppliers.

Expansion of Butter in New Zealand

- 16.34 An example of the low barriers to expansion in the consumer yellow spreads market is the growth of Westland Co-operative Dairy Company ("**Westland**") is an independent, farmer owned dairy co-operative based on the west coast of the South Island of New Zealand. Westland has approximately 400 supplier-shareholders. The company has experienced considerable growth over the last six years, and in the 2004 financial year produced in excess of **[Confidential]** metric tonnes of finished product which is greater than total domestic demand for butter (**[Confidential]** metric tonnes).
- 16.35 Fonterra understands that Westland currently supplies approximately **[Confidential]** metric tonnes of butter per annum into the domestic market. It has capacity to produce much larger volumes of AMF and butter with AMF capacity substantially increased this

year. The following are Fonterra's estimates of Westland's production for the last two years:

Product (MT)	FY03 (prod)	FY04 (prod)	FY04 (sales)	Forecast 2006
Butter	[Confidential]	[Confidential]	[Confidential]	[Confidential]
AMF	[Confidential]	[Confidential]	[Confidential]	[Confidential]

- 16.36 Its production capability can be readily diverted from butter to AMF and vice versa and its milk can be directed from other product classes into these two (see a summary of butter and AMF production issues in **Appendix 5**).
- 16.37 Westland's current domestic market strategy is to compete for customers primarily on a price basis, and to a lesser extent on a service basis. Fonterra is better placed to provide service, but is not able to provide the same level of customer specificity as Westland due to its more limited specification and product availabilities. Internationally, it can be observed that Westland placements are often priced lower than comparable Fonterra sales. This may result in a lower export parity price for the Westland domestic pricing.
- 16.38 Thus, Westland could win considerable market share on a price basis if Fonterra was not prepared to match the lower Westland pricing, although naturally to retain those customers, Westland would also need to properly service those clients with quality product and a reasonable standard of service.
- 16.39 Westland competes utilising its own brands in the retail and foodservice markets and by supplying others who would utilise their brands, including supermarkets. Westland has the capability to package butter as required by the retail market, and could expand that packaging capability by acquiring or leasing machinery or packaging plant which, as discussed in paragraphs 17.5 and 17.6, is readily available.
- 16.40 Westland already sells to NZDF for NZDF's South Island customers. That agreement is being assigned to Fonterra.
- 16.41 Westland and Fonterra compete directly on a regular basis for specific New Zealand customers. **[Confidential]**
- 16.42 Fonterra continues to be a source of bulk and packaged butter for purchase by downstream competitors. Although the Spreads Transaction will removed Fonterra's supply contract with NZDF, given the lack of constraints of imports and Westland production discussed above, Fonterra has every incentive to sell butter to those downstream at competitive prices and has in fact done so in the case of Dairymaid.

17. CONDITIONS OF EXPANSION

- 17.1 As noted above, there are few, if any, entry or expansion conditions, taking into account the ability to import, that would hinder (or have hindered in the past) new entry or further expansion by local or overseas butter or margarine suppliers. For example, there are no tariffs to be paid, import licences to be obtained, or quarantine requirements to satisfy before a new entrant imports butter or margarine from Australia or Europe.
- 17.2 Each of the current participants in the market has established a distribution network suited to the volume of consumer yellow spreads which they sell, but which could be expanded if they wanted to increase their volume in response to changes in the market. Further, there are no distribution impediments to a new entrant. This is demonstrated by

the fact that several competitors have entered the market in the last 3 years. They did so by relying on existing logistics organisations such as Toops and the supermarkets who allow them to deliver direct to the supermarkets meaning they do not need to have established distribution system.

- 17.3 In the case of sales through major supermarkets, each of Unilever, NZDF and Goodman Fielder have existing distribution relationships with the supermarkets which they could expand by the addition of new products or the expansion of existing products.
- 17.4 There are no technical knowledge barriers to entry by new participants, or expansion by existing participants, especially in butter based yellow spreads. Other products in this market such as blends and margarines based on various inputs such as olive oil, all attempt to differentiate themselves using manufacturing techniques. Nevertheless, in each of those products, there are other producers with similar technologies.
- 17.5 As noted in paragraph 11.9 above, yellow spreads consumer products are produced either by the "butter churn" (or "Fritz") technology or the SSHE (or "Amix") technique, both of which are simple processes, not relying on intellectual property rights. The "SSHE" technique can produce margarines, butter and spreads, so the same technology used to produce margarine, can easily be expanded to produce blends (and if higher pressure rated SSHE machinery is present, to make solid pats of butter, or Fritz technology can be acquired to install a butter pat line). Both types of technology are readily available on the international markets through companies such as Schroeder. **[Confidential]**.
- 17.6 The packaging (tubbing) machinery is similarly readily available. In *PolarCup (NZ) Limited/Carter Holt Harvey Products Division* (Commerce Commission Decision No. 390, 20 April 2000) the Commission considered the market for the manufacture and supply of rigid plastic food containers. The decision states at paragraph 31 that rigid plastic packaging is used by the dairy industry in preformed, printed yoghurt and cultured food containers, or in extruded plastic sheeting used in "form, fill and seal" machinery, and that rigid plastic food packaging is used by the manufacturers of margarine and butter in sizes ranging from 250 grams to 4 kg containers. The Commission noted that an undisclosed party estimated that to purchase one injection moulder, have it installed, and design and make a suitable mould would cost at least \$1 million.¹⁶ Once purchased it found that marginal costs are relatively low.
- 17.7 Fonterra's own information supports this. Suppliers of Fonterra's butter equipment advise that it is possible to acquire the equivalent packaging line to that operated by Fonterra, **[Confidential]**. All the equipment for a complete new butter processing and packing plant could be obtained for **[Confidential]**. Other options are available at even lower cost. **[Confidential]**.
- 17.8 In butter, there is minimal differentiation between manufacturing techniques. That is because butter is an internationally traded commodity, the local price of which is set by netback from the international price.
- 17.9 The product innovation taking place in the consumer yellow spreads market is not centred on butter, where the efficient market and similar manufacturing techniques used by all manufacturers (to meet the requirements of the commodity market) lead its almost exclusively price based competition.
- 17.10 More importantly, participants in the consumer yellow spreads market include very large firms, with the ability and capacity to expand their supply in the market in accordance with demand through increasing production or imports. Unilever and Goodman Fielder produce and sell very large quantities of margarine worldwide.

¹⁶ Paragraph 87.

18. INCREASED SUPPLY BY EXISTING PARTICIPANTS

18.1 For the reasons given in section 17, Fonterra considers that any of the existing suppliers could increase production of consumer yellow spreads market by any of diverting production, increasing utilisation of existing capacity, or expanding existing capacity. Westland alone could supply all the butter consumed in New Zealand without expanding its current capacity by diverting its exports into the domestic market.

19. CONDITIONS OF EXPANSION

19.1 Fonterra does not consider that any of the conditions of expansion referred to above would influence a participant's decision to increase supply.

20. TIME FOR INCREASED SUPPLY

20.1 Consumer yellow spreads producers could increase supply landed in New Zealand within 6 months.

21. COMPETITIVE CONSTRAINT ON MERGED BUSINESS

21.1 For the reasons set out above, Fonterra would be absolutely constrained by existing competitors and their ability to expand production quickly or to divert current exports to the domestic market. In particular, it would be constrained by Unilever, Rank, supermarket housebrands, Westland and imports.

22. CONSTRAINT BY EXISTING COMPETITORS

22.1 As noted above, Fonterra will be significantly constrained by the current competitors in the market. Unilever and Goodman Fielder are large international firms with products which are more innovative and appeal to an increasingly health conscious and convenience orientated market. Within the consumer yellow spreads market, butter has suffered a loss of market share and reducing price over many years, reflecting the increasingly innovative products being offered by companies such as Unilever and Goodman Fielder.

23. CO-ORDINATED MARKET POWER

23.1 Fonterra considers that the consumer yellow spreads market has a number of characteristics which would impede co-ordination effects post-acquisition, including:

- (a) the countervailing power of the supermarkets including the rapid development of housebrands;
- (b) the level of differentiation between products;
- (c) the low-barriers to entry and expansion; and
- (d) the presence of fringe and niche competitors.

Countervailing power of the supermarkets

- 23.2 In the consumer yellow spreads market, **[Confidential]**% of sales are through supermarkets. The countervailing power of those supermarkets is discussed at paragraphs 16.19 to 16.25.

Differentiated products

- 23.3 The consumer yellow spreads market is characterised by differentiated products and therefore it is more difficult for participants to agree on a price. Such behaviour is further constrained by different cost structures for the main participants, including the different sources of margarine and the different cost structure for butter.

Low barriers to entry

- 23.4 New firms both through imports and local production could enter the market without difficulty.

Presence of fringe and niche competitors:

- 23.5 There are a number of fringe competitors such as Universal Foods (**[Confidential]**%) and Dairymaid (**[Confidential]**%) which could expand their distribution of locally produced and imported products, in response to any attempt to increase prices, without difficulty.

24. CHARACTERISTICS THAT FACILITATE MONITORING OF CO-ORDINATED BEHAVIOUR

- 24.1 The differentiation of costs, especially in relation to the manufacture of butter compared to margarine, would make monitoring and enforcement difficult.

25. NO EVIDENCE OF PRICE CO-ORDINATION, PRICE MATCHING OR PRICE FOLLOWING

- 25.1 Fonterra is not aware of any price co-ordination in either market, nor of any factors present in either market, which might suggest any price co-ordination, price matching or price following by market participants.
- 25.2 With respect to the butter segment of the market, as butter is an internationally traded commodity, the base prices are reviewed when commodity prices move, especially over the longer term.

26. NO RISK OF CO-ORDINATED BEHAVIOUR IN THE RELEVANT MARKET

- 26.1 The features currently present in the market, which make co-ordination unlikely (set out at paragraph 23.1 above), will not change as a result of the acquisition. Rather, they will continue to contribute to a highly competitive market.

PART IV: CONDITIONS OF ENTRY

27. NO BARRIERS TO ENTRY TO CONSUMER YELLOW SPREADS MARKET

27.1 None of the conditions identified would act as a barrier to the consumer yellow spreads market. There are no significant frontier entry conditions or legislative/regulatory constraints. Consequently, the only relevant condition is finding a reliable source of product or establishing sufficient manufacturing capability.

28. POTENTIAL NEW ENTRANTS

28.1 The following key Australian manufacturers of butter and margarine could begin supplying yellow spreads in New Zealand:

- (a) **Murray Goulburn Co-Operative Co Limited** is the largest co-operative and buyer of raw milk in Australia. Products manufactured and sold by Murray Goulburn include butter, butter blends, AMF, and BMP. Murray Goulburn is also a major participant in the supply of housebrand/generic butter and cheese for the major supermarket chains. According to internal data, Fonterra understands that Murray Goulburn supplies an estimated **[Confidential]**% of the total generic butter consumed each year in Australia.
- (b) **Parmalat Australia Pty Ltd/Pauls Limited** is a wholly owned subsidiary of Parmalat, an Italian public company, and specialises in the production of branded milk and dairy products. It is one of Australia's major processors of milk, yoghurt and fresh dairy products. Products supplied by Parmalat/Pauls include butter and buttermilk.
- (c) **Australian Co-operative Foods Limited (trading as Dairy Farmers)** is Australia's largest dairy business. Dairy Farmers' products include butter and BMP.
- (d) **Bega Co-Operative Society Limited** is owned by 135 dairy farmer/shareholders from the Bega Valley. Bega's products include butter.
- (e) **Warrnambool Cheese and Butter Company Limited** is a processor and supplier of milk, and a large dairy manufacturer. Warrnambool's product range includes butter, BMP, and butter blends.
- (f) **Tatura Milk Industries Limited** is a large dairy manufacturer. Tatura supplies butter for retail consumption and also supplies generic brand butter to the major supermarket chains around Australia. Tatura's product range includes AMF, butter, butter blends, and butteroil.
- (g) **Norco Co Operative Limited** is a New South Wales based milk processor and dairy manufacturer. Norco's products include butter.
- (h) **Ballantyne Foods Pty Ltd** is a Victorian based family company. Ballantyne is the world's largest producer of canned butter with exports throughout Asia, the Pacific, the Middle East and the Americas. Ballantyne's product range includes butter and butter blends.
- (i) **Butter Producers Co-Operative Society Limited** manufactures butter and ghee under the QBB brand.

- 28.2 The prices of cheese and butter in New Zealand and Australia are similar. Consequently Australian manufacturers would be able to enter the New Zealand market without difficulty.
- 28.3 In addition **San Miguel** is a major supplier of dairy products. Its products include "Butter Cup Margarine", "Dari Crème" (margarine), "Dari Crème Lite" (margarine), "Magnolia Gold Butter", "Star Margarine", and "Baker's Best Margarine". San Miguel has extensive international manufacturing and distribution capabilities and would have the skills and product to enter the New Zealand market.
- 28.4 **Tatua Co-operative Dairy Company Limited** are currently commissioning an AMF plant. Details of their potential production capacity are not known, however, AMF production could be converted to butter production.

29. NO CONDITIONS OF ENTRY DETERRENCE

- 29.1 Approximately [**Confidential**]% of the total consumer yellow spreads market is sold through supermarket chains which have major countervailing power with the ability to encourage alternative supply arrangements with incumbents and/or potential entrants.

30. LIKELIHOOD, SUFFICIENCY AND TIMELINESS OF ENTRY

- 30.1 Entry could occur at any time with very little lead time. A new minor entrant could commence by securing butter from Westland or Fonterra or from imports, and build a distribution business and brand over time. A major entrant, such as NZDF, Unilever or Goodman Fielder could use their existing distribution networks and supermarket relationships. Supermarkets could simply expand their existing network and brand.
- 30.2 Any of these entrants could enter profitably.
- 30.3 The threat of entry would be either widespread or niche, as explained above, and both are likely to constrain existing market participants.
- 30.4 NZDF will be an effective competitor to the merged Mainland and ex NZDF butter and spreads businesses, as it has a distribution system suited to the sale of consumer yellow spread to supermarkets and other outlets. NZDF and Fonterra have terminated their current butter supply contract, with effect upon the sale of NZDF's butter and spreads business to Fonterra becoming unconditional, but NZDF could readily acquire packaged butter from Westland, or imports, as other new entrants have demonstrated.
- 30.5 NZDF will continue to sell Fonterra butter to foodservice and route outlets as distribution agent for Fonterra. NZDF could introduce its own butter (acquired from Westland or imports) as a competition product for sale to those outlets.
- 30.6 As there are no significant frontier entry conditions or legislative/regulatory constraints the only condition that would influence de novo entry is finding a reliable source of product or establishing sufficient manufacturing capability. As recent examples of de novo entry demonstrate this is not difficult. For example, niche players Universal Foods and Dairymaid have been able to source and supply butter to supermarkets such as Pak N Save in Wellington and lower North Island Foodstuffs outlets.
- 30.7 Within the market there are significant constraints. De novo entry is one of those constraints but it is not as significant as the countervailing power of the supermarkets and the ease at which current competitors could increase supply.

PART V: OTHER POTENTIAL CONSTRAINTS

31. CONSTRAINTS ON MARKET POWER BY THE CONDUCT OF SUPPLIERS

- 31.1 As discussed above, in response to question 7, Fonterra is currently the exclusive supplier of butter to the Mainland butter and spreads business. NZDF sources butter from both Fonterra and Westland. Fonterra will continue to manufacture the butter used in both businesses. The only change is that they will also be marketed and distributed by Fonterra. If NZDF wishes to re-enter the market it will be able to do so by acquiring butter from an alternative supplier such as Westland or from imports, and would be able to acquire margarine from any of the suppliers noted above.
- 31.2 Fonterra is an integrated dairy products company, and it currently acquires all its butter from its Ingredients division (although as described at paragraph 16.40 as part of the Spreads Transaction Fonterra will acquire NZDF's Westland butter supply contract). Fonterra purchases small quantities of margarine from Goodman Fielder as described in 13.3. In addition margarine is available at international commodity prices.

32. CONSTRAINTS ON MARKET POWER BY THE CONDUCT OF ACQUIRERS

- 32.1 **[Confidential]**% of the sales of consumer yellow spreads are through supermarkets. The ownership of the supermarkets is set out in paragraph 16.19 above, and the role they play in exerting countervailing power in this market is described in paragraphs 16.19 to 16.25.
- 32.2 For the reasons set out in response to question 23 the supermarkets have substantial countervailing power.

THIS NOTICE is given by Fonterra Co-operative Group Limited.

I, David Matthews, am authorised to make this application on Fonterra Co-operative Group Limited's behalf.

I hereby confirm that:

- (a) All information specified by the Commission has been supplied;
- (b) All information known to the applicant which is relevant to the consideration of this application has been supplied;
- (c) All information supplied is correct as at the date of this application.

I undertake to advise the Commission immediately of any material change in circumstances to the application.

Dated 29 August 2005

David Matthews
General Counsel, Fonterra

I am duly authorised to make this application.

APPENDIX 1
Fonterra Corporate Structure

APPENDIX 2

Consumer Yellow Spread Market Current Shares

Participant	Sub-Category	Brands	Pre-Transaction			Post-Transaction	
			Volume	Share	Total	Share	Total
Rank	Goodman Fielder	Choice Gold N Canola Meadow Lea (Standard) Meadow Lea Logicol Meadow Lea Omega Olivani Slimarine Sunrise	[Confidential]				
	NZDF	Anchor Country Soft Fernleaf Golden Fern					
	Total Rank Group						
Unilever		Bertolli Country Croc Flora Flora Buttery I Can't Believe Miracle Praise Reg					
Fonterra	Mainland	Mainland Semi Soft Mainland Southern Blend Mainland (Standard)					
	Bonlac	Dairy Smooth					
	NZDF brands						
Total Fonterra							
Housebrands*	Progressive	Basics Signature Range					
	Foodstuffs	Budget Pams					
	Other Housebrands	Gilmours Chefs Pantry					
	Total Housebrands						
Universal Foods		Classic Farm					
National Foods		Dairymaid					
Others		Bakel Canary Canola Ceres Craigs Link Lurpak Melrose Sunbeam Tableland Ultima Vitalite					

Source: Aztec Data, as at 10 July 2005.

***Note to table:**

- The housebrand spreads market share of **[Confidential]**% consists of **[Confidential]**% butter and **[Confidential]** % margarine. Consequently, NZDF's pre-transaction share with housebrands is approximately **[Confidential]** %. Once moved to Fonterra, Fonterra's combined share is approximately **[Confidential]**% and post-transaction will be **[Confidential]**%. Progressive's housebrand margarine is sourced from Peerless. Foodstuff's housebrand margarine is sourced from Goodman Fielder. Consequently, Ranks total pre-transaction share of the consumer yellow spreads market is **[Confidential]**% and will be **[Confidential]**% post-transaction. However, as noted in the application, the parties do not consider that it is appropriate to amalgamate the

shares in this way, in light of the fact that the housebrand portion of this share is easily transferable to other suppliers.

2. In the butter segment of the market where aggregation occurs, Fonterra's post-transaction market share would be **[Confidential]**%. If housebrands were to be added to this, it would be **[Confidential]**%. However, as noted in the application, the parties do not consider that it is appropriate to amalgamate the shares in this way, in light of the fact that the housebrand portion of this share is easily transferable to other suppliers.

Other remaining competitors in the butter segment are Classic Farm, Dairymaid, Canary, Ceres, Craigs, Farmgate, Link, Lurpak, and Smart Balance.

APPENDIX 3
Heads of Agreement

APPENDIX 4

Impact of the Heads of Agreement

Principles of the Main Transaction

1. The Heads of Agreement requires Fonterra to acquire the New Zealand retail dairy business assets of NZDF, with the exceptions discussed below. NZDF as a legal entity would remain a subsidiary of Rank. At the same time Rank will acquire, through the acquisition of all the shares in Mainland, the New Zealand retail dairy business assets of Fonterra, with the exceptions discussed below. Each acquisition would be conditional on the other, and completion would occur contemporaneously. As a result, those businesses would continue to operate and compete in the same markets before and after the Main Transaction, with the same leadership and management teams remaining with the same brands and products.

Exceptions

2. The main exceptions to these principles are that:
 - (a) Fonterra and NZDF will retain their respective cheese businesses unchanged from their present operations. NZDF's current "Anchor" brand licence will terminate after 10 years (the "Anchor" brand licence used in relation to other dairy products will transfer to Fonterra along with all other assets of those businesses);
 - (b) Fonterra will acquire NZDF's branded butter and consumer yellow spreads business but will not sell its corresponding business to NZDF. This is the Spreads Transaction which is the subject of this clearance application; and
 - (c) NZDF will also acquire Fonterra's smallgoods and meats business, and Fonterra will acquire NZDF's dairy export business.

Markets affected by the Main Transaction

3. The Commission has considered New Zealand dairy markets in considerable depth over recent years. A summary of the markets adopted in the relevant decisions is set out in **Appendix 6**. Fonterra has not sought to reach a concluded view as to whether wider product markets may exist encompassing more than one type of dairy product (for example, a manufactured dairy products market or, in relation to cheese, a generic cheese market) affected by the Main Transaction. This is because, even when the Main Transaction is assessed within the framework of narrow specific product markets, it would not (and would not be likely to) lead to a substantial lessening of competition in any of those markets.
4. In each market the Main Transaction will not lead to a change in the competitive dynamic (and, as a result, will not lead to a substantial lessening of competition). This is because in each dairy products market, except consumer yellow spreads, one of two outcomes will occur, neither of which would result in a change to market concentration. The outcomes are:
 - (a) *Direct swap*: Fonterra will acquire all of NZDF's current business units and NZDF will acquire of all of Mainland's current business units; or
 - (b) *No swap*: In the cheese market, Fonterra will retain all of Mainland's current brands and NZDF will retain of all of NZDF's current business units.

- (c) In the consumer yellow spreads market there will be some aggregation but, as this clearance application will show, this will not lead to a substantial lessening of competition. In the smallgoods market there will be no aggregation and in the fruit drinks market there will be no significant aggregation.
5. Markets in which there is a direct swap are:
- (a) Market for the processing and wholesale supply of Town Milk in each Island;
 - (b) Market for the processing and wholesale supply of UHT and powdered milk;
 - (c) Market for the manufacture and supply of cultured dairy products;
 - (d) Market for the manufacture and wholesale supply of yoghurt and dairy food; and
 - (e) The market for the wholesale supply of dairy products to the foodservice and route trades, although Fonterra does not believe that this represents a relevant market for the purposes of this analysis.
6. Markets in which there is no swap are:
- (a) Market for the manufacture and wholesale supply of block cheese (including processed and grated cheese);
 - (b) Market for the manufacture and wholesale supply of speciality cheese; and
 - (c) Market for the manufacture and wholesale supply of dairy ingredients.
7. The market in which there is no aggregation is that for the manufacture and wholesale supply of "smallgoods".
8. Markets in which there is aggregation but no significant lessening of competition:
- (a) Market for the manufacture and wholesale supply consumer yellow spreads; and
 - (b) Market for the manufacture and wholesale supply of fruit drinks.

Each of those markets will now be considered in summary.

Market for wholesale supply of town milk

9. The Commission's previous approach has been to treat a variety of milk types, flavoured fresh milks, and cream, as forming part of the same market.¹⁷
10. Under the Main Transaction on the demand side:
- (a) Fonterra will obtain all of NZDF's business and NZDF will acquire all of Mainland's business (other than Supashake which is a new product launched in April 2005); and
 - (b) Fonterra will honour the obligations under NZDF's housebrand contracts and NZDF will honour those of Mainland. Housebrand customers routinely tender their contracts and change provider. In addition the contracts are usually only 1-2 years' duration. More recently Foodstuffs (Wellington), a major

¹⁷ Decisions 428 and 454: Mainland Products Limited/Southern Fresh Company Limited, paragraph 28.

housebrand customer, has chosen not to purchase from either of the participants and instead develop their own operations.

11. Under the Main Transaction, on the supply side:
- (a) Fonterra will acquire NZDF's milk manufacturing assets at the Takinini plant and equipment at the Hornby site in Christchurch. Fonterra will allow NZDF to use the Hornby plant and equipment for so long as it does so to provide processing and packing services to Fonterra which are discussed below. NZDF will retain its stake in its small bottling plant at Blenheim.
 - (b) NZDF will acquire all of Mainland's milk manufacturing assets (ie the Longburn, Palmerston North and Blenheim Road, Christchurch, plants).
 - (c) NZDF will provide milk processing and bottling services to Fonterra, utilising the plant acquired from Fonterra and the ex NZDF plant in Hornby, Christchurch, which has been sold to Fonterra. Under this agreement NZDF will deliver bottled milk to Fonterra's Christchurch and Blenheim distribution warehouses. The agreement is non-exclusive, so that NZDF may process milk for other customers, and Fonterra may use other suppliers, or process its own milk and supply other customers in competition with Rank.
 - (d) The current raw milk supply agreements between Fonterra and NZDF will continue, although certain commercial advantages offered to NZDF in addition to its rights under the Raw Milk Regulations will be reduced, to reflect NZDF's reduced purchases.
12. On the supply side, as the number of recent entrants to the market demonstrate, this market has no barriers to entry. For example bottling operations have been established by Emerald Foods South Island Limited, Gisborne Milk Co-op Limited, Kapiti Fine Foods Limited, and Taranaki Milk Products Limited. Entry is facilitated by Tetra-Pak and other providers of packing plants in return for supplying the necessary packaging materials.
13. There will be no other change to the operation of the businesses.
14. The Main Transaction will not result in aggregation in wholesale town milk supply. Fonterra will gain a greater market share and, conversely, NZDF's market share will decrease. However, the number of market participants will remain constant and the change in itself will have no impact on the underlying competition dynamics of the market and nor will it raise barriers to entry or expansion.

Market for the wholesale supply of UHT and powdered milk

15. The Commission has previously considered that processed milk (UHT, powdered milk and processed cream) falls within a cultured dairy products market (while recognising the narrower product markets might in fact exist).¹⁸ Fonterra considers that UHT has the potential to significantly constrain pricing in the town milk market (and may, in fact, form part of that market). However, for present purposes Fonterra has considered the effect of the Main Transaction on a separate (narrower) market for processed milk (ie milk powder and UHT milk).
16. Under the Main Transaction, on the demand side:
- (a) Fonterra will obtain the NZDF business using the "Anchor" brand (being NZDF's current brand); and

¹⁸ Draft determination for the formation of *MergeCo*, paragraph 205.

- (b) NZDF will acquire Fonterra's business using the "Meadow Fresh" brand (being Mainland's current brand).
17. Under the Main Transaction on the supply side Fonterra will acquire NZDF's UHT manufacturing assets (ie the Takanini plant) and NZDF will acquire Mainland's UHT manufacturing assets (ie the Blenheim Road, Christchurch, plant). The UHT currently manufactured by Fonterra at the Blenheim Road plant is mainly for export. As the Takanini plant does not have sufficient capacity to meet all of Fonterra's UHT export requirements, Fonterra will enter into a contract pack arrangement with NZDF for the production and supply of UHT milk for export by Fonterra.
18. In relation to milk powder, NZDF currently sells milk powder products, manufactured on its behalf by Fonterra, under the "Anchor" brand. This business will transfer to Fonterra. No aggregation will result as Fonterra (Mainland) does not sell in New Zealand any consumer milk powder products.
19. This bare transfer and swap will not have any material impact on competition.

Market for the manufacture and wholesale supply of yoghurt and dairy food

20. The Commission's previous approach has been to treat both yoghurt and dairy food (but not homemade yoghurt) as forming part of the same market.¹⁹
21. Under the Main Transaction, on the demand side:
- (a) Fonterra will acquire all of NZDF's business; and
- (b) NZDF will acquire all of Mainland's business.
22. Under the Main Transaction on the supply side:
- (a) Fonterra will acquire NZDF's yoghurt and dairy food manufacturing assets (ie the Takanini plant); and
- (b) NZDF will acquire Mainland's yoghurt and dairy food manufacturing assets (ie the Longburn and Russley Road, Christchurch, plants).
23. The competition impact of this bare swap will be much the same as for UHT and powdered milk.

Market for the manufacture and wholesale supply of cultured dairy products

24. In *MergeCo* the Commission considered that the cultured dairy products market contained both processed milk and cultured dairy products (such as yoghurts, dairy foods, dairy desserts, custard, cottage cheese, sour cream and dips). In the second National Foods decision, the Commission has subsequently considered that yoghurt and dairy foods fall into a separate market.²⁰ Fonterra has, for the purposes of this analysis, proceeded on the basis that processed milk forms a separate (narrower) market, and that the cultured dairy product market is restricted to products such as cottage cream, cream cheese, sour cream and dips.
25. Under the Main Transaction on the demand side:
- (a) Fonterra will obtain NZDF's current business using the "Country Goodness" brand; and

¹⁹ Decision 542: Fonterra Co-operative Group Limited/National Foods Limited, paragraph 62.

²⁰ Decision 542: Fonterra Co-operative Group Limited/National Foods Limited.

- (b) NZDF will acquire Tararua (being Mainland's current brand).
26. Under the Main Transaction on the supply side:
- (a) Fonterra will obtain NZDF's cultured dairy product manufacturing assets (ie the Takanini plant); and
- (b) NZDF will obtain Mainland's cultured dairy products manufacturing assets (ie the Longburn and Russley Road, Christchurch plants).
27. The competition impact of this swap will be much the same as for yoghurt and dairy foods.

Market for the wholesale supply of block cheese (including processed and grated cheese)

28. The Commission's previous approach has been to treat speciality cheese and block cheese as forming part of the same product market.²¹ Although Fonterra considers this is correct it has for present purposes considered the effect of the Main Transaction on separate (narrower) markets for speciality cheese and for natural cheese.
29. Under the Main Transaction on the demand side:
- (a) Fonterra will retain the business owned by Mainland including Mainland's housebrand contract with Progressive; and
- (b) NZDF will retain its current business including its housebrand contract with Foodstuffs.
- (c) Under the Heads of Agreement on the supply side each party will retain its current operating assets.
30. The "Anchor" licence will be reduced from its current perpetual term to a ten year term. NZDF already has major brands in its market, and as part of the Main Transaction NZDF acquires brands now used by Fonterra, through Mainland Products Limited.
31. The result of this is that the structure of the market will remain unchanged.

Market for the manufacture and wholesale supply of specialty cheese

32. Under the Main Transaction:
- (a) Fonterra will retain the Mainland, Ferndale, Perfect Italiano, and Galaxy brands and business; and
- (b) NZDF will retain the "Anchor", "Puhoi Valley", "Bouton d'or", and "Ornelle" brands and business.
33. The "Anchor" licence will be for a ten year term rather than the current perpetual licence, as discussed above.
34. The result of this is that the structure of the market will remain unchanged.

²¹ Decision 341: Kiwi Co-op Dairies/Southern Dairy Co-op, paragraph 72.

Market for the wholesale supply of consumer yellow spreads

35. Under the Main Transaction, either there will be an acquisition of NZDF's "Anchor", "Fernleaf" and "Country Soft" branded consumer yellow spreads business by Fonterra (if this clearance application is granted) or NZDF will retain that business. However, the transfer of the unbranded business (including housebrand contracts, again, subject to customer agreement where relevant) by NZDF to Fonterra is not subject to that condition.

Market for the wholesale supply of dairy ingredients

36. The Commission's previous approach has been to treat the large number of products (grouped for convenience under the categories of: proteins, oils and fats, flavourings, and stock feed) used by both dairy companies and others as intermediate inputs as one market.²²
37. Under the Main Transaction there will be no change to this market as NZDF's contracts will continue.

Market for the wholesale supply of smallgoods

38. The Commission's previous approach has been to treat cold meats (eg ham, salami), warm meat (eg bacon, sausages) and frozen convenience foods as forming part of the same "smallgoods" market.²³ In its determination in relation to Mainland Products Limited/Food Solution Group Limited the Commission stated:

The word "smallgoods" does not have a precise definition, but it is a term which is used in New Zealand and Australia to describe a range of processed meat products...When sold by retailers, the products may be offered in delicatessens or in the delicatessen departments of supermarkets, or, when the products are pre-packed, from chilled storage cabinets. Some of the products are customarily consumed cold (eg ham, pastrami, salami and luncheon sausage) while some are usually cooked and served warm (bacon, saveloys and sausages). While these products are not necessarily direct substitutes, there is sufficient commonality for them to be treated together.²⁴

39. Under the Main Transaction NZDF will acquire Mainland's smallgoods business. However, NZDF does not currently produce or market smallgoods. As a result there will be no aggregation in the smallgoods market.
40. In addition NZDF will continue to distribute Mainland butter and cheese.

Market for the wholesale supply of fruit drinks

41. The Commission's previous approach has been to treat fruit juice and fruit drinks as forming part of the same market.²⁵
42. Fonterra (through Mainland) currently sells a small amount of fruit juice through its Cool Change and Fru Ju brands. NZDF sells a small amount of fruit juice through Zing which will be acquired by Fonterra.
43. Under the Main Transaction, Fonterra will retain its Fru Ju branded business and will swap its Cool Change business for NZDF's Zing business. The market shares of Cool Change, Fru Ju and Zing are insignificant. The acquisition will not lead to any significant aggregation of market shares as the aggregation will be less than 1%.

²² *MergeCo*, paragraph 209.

²³ Decision 334: Mainland Products Limited/Food Solutions Group Limited.

²⁴ Paragraph 18.

²⁵ Decisions 480 and 481: Burns Philp/Goodman Fielder, paragraph 48.

APPENDIX 5

Production Process of Butter

Uses for milk and cream

1. The milkfat and solids contained in manufacturing milk can be used to produce a wide variety of products, and the production of some products are joint or complementary in the sense that each can be made from separate components of the same milk.
2. Fresh cows milk is made up of approximately 4.2% fat, 3.5% protein, 5% other solids, about 88% water and bacteria. The first step in processing fresh cows milk into any other product is to standardise the milk. Standardisation is merely separating the components in milk by a way of a centrifugal standardiser which can separate the milk either completely or to a degree into its different components
3. A by-product of the standardisation process is cream. The cream removed during standardisation can be bottled as table cream or manufactured into butter or other dairy products.
4. Every processing plant has a standardiser/separator of milk components and as such, every plant can produce cream and skim milk or standardised full cream milk.

Butter

5. The first step in making butter is, through standardisation or separation, to separate wholemilk into cream and skim milk. The cream is then churned until the fat globules form into solid butter and leave a liquid by-product, known as buttermilk.
6. The components of butter are 81.5% fat, 4.5% other solids, 14% water.
7. There are two principal butter-making processes:
 - (a) the Fritz continuous churning process; and
 - (b) the Ammix process.
8. In both processes, other ingredients such as salt, flavouring and culture, can be added to meet consumer needs.

Anhydrous milkfat (AMF) and Ghee

9. Like butter, AMF and Ghee are also made from cream. The process is similar to that used for butter, except there is a change in the proportional components of the product. In this case, to the point where the product is almost 100% fat. Again, like butter, a by-product of the churning process, is buttermilk.

Buttermilk

10. As described above, buttermilk is the by-product of churning. Once extracted, the buttermilk liquid can then dried to make BMP.
11. The components of buttermilk are 1% fat, 7% other solids and 92% water. The components of BMP are 10% fat, 4% water, 86% other solids, primarily proteins.

APPENDIX 6
Summary of Market Definitions Adopted by the New Zealand Commerce Commission

Decision	Parties	Markets (as relevant)	Products included/Comments
324	Mainland Products/South Island Dairy Farmers Co-op	Manufacture and wholesale supply of yoghurt and other cultured dairy products.	Cultured dairy products included sour cream, cottage cheese, cream cheese. Acknowledged a wider market for all dairy foods <i>could</i> exist.
		Processing and wholesale supply of powdered milk products.	
		Processing and supply of town milk.	Does not include UHT. New Zealand very much a "fresh milk market".
334	Mainland Products/Food Solutions Group	Wholesale distribution of "smallgoods"	Smallgoods meant processed meat products. Can be consumed cold (eg ham, pastrami, salami) or warm (bacon, saveloys and sausages). Frozen convenience foods (eg hamburger patties, fish cakes, hot dogs) and pig-farms activities were undertaken by Food Solutions, but not Mainland, so not considered further.
341	Kiwi Co-op Dairies/South Island Dairy Co-op	Manufacture and supply of wholesale cheese.	Acknowledged a wider market for manufactured dairy products <i>could</i> exist.
"Merge Co"	Draft determination for formation of "MergeCo" (Fonterra)	Processing and wholesale supply of town milk.	All types of milk, flavoured milk, cream. UHT probably not in this market, but comments sought.
		Manufacture and wholesale supply of cheese.	Two sub-categories: Main (block) cheese (including processed and grated) and speciality cheese.
		Manufacture and wholesale supply consumer spreads.	Includes consumer (not industrial) butter and other blends.
		Manufacture and wholesale supply of cultured dairy products.	Cultured dairy products separated into processed milk (eg UHT, powdered milk, processed cream), which all have relatively long shelf-lives; and fresh dairy foods (eg yoghurts, dairy foods, dairy desserts, custard, cottage cheese, cream cheese, sour cream, dips), which are of limited shelf life and generally require chilled storage. Recognised that narrower markets might exist but without econometric evidence, hard to define. Because proposed merger resulted in dominance concerns in all markets treated as one market for the analysis.

Decision	Parties	Markets (as relevant)	Products included/Comments
		Manufacture and wholesale supply dairy ingredients.	Intermediate inputs for manufacturing companies. Four categories: proteins, oils and fats, flavouring, stock feed. Includes industrial supply of products that fall in consumer markets (eg bulk cheeses, butter).
396	Mainland Products/Nelson Milk	Processing and supply of town milk.	All types of milk, flavoured milk, cream.
428/454	Mainland Products/Southern Fresh Milk	Processing and wholesale supply of town milk.	Includes different milk types, flavoured fresh milk and cream.
459	National Foods ("Yoplait")/NZDF ("Fresh'n'Fruity")	Manufacture and wholesale supply of yoghurt and dairy desserts.	Separate market from other forms of cultured dairy foods.
480/481	Coca-Cola/Rio Beverages	Wholesale supply of fruit juices and fruit drinks.	Market segments: chilled juice, shelf-stable juice.
487	Burns Philp/Goodman Fielder	Manufacture and wholesale supply of consumer yellow spreads.	
542	Fonterra/National Foods	Manufacture and wholesale supply of yoghurt and dairy food.	Other cultured products are not in the same market. Homemade yoghurt excluded from market.