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COMMERCE COMMISSION

Decision No. 524

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

VISY INDUSTRIAL PLASTICS (NZ) LIMITED

and

ACI OPERATIONS NZ LIMITED

The Commission: Paula Rebstock
Donal Curtin
David Caygill

Summary of Application: The acquisition by Visy Industrial Plastics (NZ) Limited of the plastics packaging business and assets of ACI Operations NZ Limited.

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

Date of Determination: 26 May 2004

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EXECUTIVE SUMMARY .... **I**

THE PROPOSAL **1**
PROCEDURE **1**
STATUTORY FRAMEWORK **1**
ANALYTICAL FRAMEWORK **2**
THE PARTIES **2**
Visy Industrial Plastics (NZ) Limited (VIP) **2**
VisyPET (NZ) Limited, trading as VisyPak (Visy) **3**
OTHER RELEVANT PARTIES **4**
PET Bottle Manufacturers **4**
Amcor Packaging (New Zealand) Limited (Amcor *4*
Alto Plastics Limited (Alto) *4*
TSL Plastics Limited (TSL) *5*
Beverage Fillers **5**
Coca-Cola Amatil (NZ) Limited (CCA) *5*
Frucor Beverages Group Limited (Frucor) *5*
Bevpac NZ Limited (Bevpac) *6*
PREVIOUS DECISIONS **6**
INDUSTRY BACKGROUND **6**
The Non-alcoholic Beverage Industry **6**
Supply Agreement between CCA and Visy **9**
ASSOCIATION **11**
MARKET DEFINITION **15**
Product Market **15**
Beverage containers *16*
Distribution channels *16*

Hot-fill vs. Cold-fill *19*
Functional Market **20**
Geographic Market **20**
Conclusion on Market Definition **21**
COUNTERFACTUAL AND FACTUAL **21**
Factual **21**
Counterfactual **22**
COMPETITION ANALYSIS **22**
Existing Competition **22**
Conclusion on Existing Competition **33**
Potential Competition **34**
Barriers to Entry *34*
Conclusion on Barriers to Entry *35*
The "LET" Test *36*
Conclusion on Potential Competition **37**
Countervailing Power **37**
Countervailing Power of Suppliers *37*
Scope for the Exercise of Coordinated Market Power **38**
Co-ordinated Behaviour *39*
Detection *42*
Retaliation *42*
Conclusion on Scope for the Exercise of Coordinated Market Power43
OVERALL CONCLUSION **44**
DETERMINATION ON NOTICE OF CLEARANCE **46**

EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to s 66(1) of the Commerce Act (the Act) was registered on 23 March 2004. The notice sought clearance for the acquisition by Visy Industrial Plastics (NZ) Limited (VIP) of the plastics packaging business and assets of ACI Operations NZ Limited (ACI).

Market Definition

2. The Commission concludes that the relevant market for this acquisition is the New Zealand market for the manufacture and supply of PET bottles for non-alcoholic beverages.

Association

3. The Commission has concluded that VIP and VisyPak (Visy) are likely to be associated entities.

Counterfactual

4. The Commission considers that the appropriate counterfactual in this case is the acquisition by another party, or ACI continuing to operate its PET assets, which is the status quo.

Competition Analysis

Existing Competition

5. The Commission is of the view that because of an existing [ ] supply agreement between CCA and Visy, not all PET bottles produced in New Zealand should be included in the PET bottle market.
6. The Commission notes that the potential for the Supply Agreement between Visy and CCA to [ ] of the PET bottle market exists absent the proposed acquisition.
7. The Commission considers that the measure of market share that would best highlight any potential competition concerns is capacity.
8. The proposed acquisition would see a reduction in the number of competitors from five to four, with one of those four being a fringe player. The Commission considers that Alto and Amcor are presently strong competitors. [ ].
9. [ ]. To this extent, the Commission has investigated whether the proposal would afford the combined entity such efficiencies that they could represent a barrier to expansion by existing players and

ultimately lead to their exit from the market. The Commission is of the view that the acquisition is unlikely to increase barriers to expansion by existing participants.

10. In addition, the Commission has explored whether [ ]. There would remain a significant amount of business in the market for which [ ].

11. The Commission considers that the existing competitors Amcor, Alto and TSL all have considerable excess capacity. In addition, they each have the ability and incentive to expand their operations quickly and easily if required, such that they would provide a significant degree of constraint on the combined entity.

12. Therefore, the Commission concludes that existing competition would provide a significant degree of constraint on the combined entity.

Potential Competition

13. The Commission considers that the excess capacity of existing competitors and the difficulty a new entrant would experience in securing supply agreements represent significant barriers to entry such that de novo entry to the PET bottle market is unlikely.

Countervailing Power

14. The Commission considers that [ ] would provide a degree of constraint on the combined entity. In addition, Frucor would provide a significant degree of countervailing power on the combined entity through its ability to self-supply and also through its demonstrated ability to sponsor expansion.

Scope for the Exercise of Co-ordinated Market Power

15. The possibility of Visy and [ ] being able to co-ordinate their behaviour as a result of the proposed acquisition in order to share the PET bottle market rests largely on a set of assumptions including [ ].

16. In the event, that [ ].

17. Although presently a [ ], which has sponsored expansion in the past.

18. Frucor would hold a significant degree of countervailing power over both Visy and [ ] through its ability to sponsor a third player and also through its ability to self-supply, such that even in the event that Visy and [ ] did enter into a market sharing arrangement, it is unlikely that they could sustain any such arrangement.

19. Detection of deviation from any such arrangement would be easy for both Visy and [ ], although retaliation by [ ]. However, any unilateral market power that [ ] might derive from such a

situation would be tempered by Frucor's significant degree of countervailing power.

20. Accordingly, the Commission is of the view that it is unlikely that Visy and [ ] would co-ordinate their behaviour to share the market and that even if they, did, any such arrangement would be likely to be difficult to sustain.

Overall Conclusion

21. On balance, the Commission concludes that, in the face of any attempt by the combined entity to raise prices, the existing level of competition, together with the ability of existing participants to expand, and the significant countervailing power of Frucor would be sufficient to constrain the combined entity. Therefore, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for PET bottles.

22. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by VIP of the plastics packaging business and assets of ACI.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act (the Act) was registered on 23 March 2004. The notice sought clearance for the acquisition by Visy Industrial Plastics (NZ) Limited (VIP) of the plastics packaging business and assets of ACI Operations NZ Limited (ACI).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Three extensions of time were agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 27 May 2004.
3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach to analysing this proposed acquisition is based on principles set out in the *Commission's Merger and Acquisition Guidelines.*

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission may grant clearances for acquisitions where it is satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[1]
6. The Commission considers that it is necessary to identify a real lessening of competition that is not minimal.[2] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.
7. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years.
8. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced service, quality or innovation, for there

[1] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[2] See Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

to be a substantial lessening, or likely substantial lessening, of competition, these also have to be both material and sustainable for at least two years.

ANALYTICAL FRAMEWORK

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

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

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

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

THE PARTIES

Visy Industrial Plastics (NZ) Limited (VIP)

11. VIP is a New Zealand company wholly owned by Visy Industrial Holdings (NZ) Limited (VIH). An ownership structure diagram showing ownership of the companies interconnected with VIP (Salvage Group) is provided in Appendix 1.

12. VIP was formed in 2002, by its chairman, Raphael Geminder. Mr Geminder, who is the son-in-law of Richard and Jeanne Pratt, the owners of Visy Industries, acquired some rigid packaging assets of Visy Industries in Australia and New Zealand and commenced trade as VIP.

13. VIP's plant at Onehunga in Auckland manufactures products from polyethylene materials. This includes a limited range of industrial bottles from 500ml to 100ltr, as well as some retail market products such as petrol containers, watering cans, piggy banks, etc. VIP has also developed a 10 litre pail and it has **[ ]**. To date **[ ]**. VIP currently has no PET container capability.

14. VIP stated that post-acquisition, it intends to on-sell the two-stage PET bottle assets of ACI, and that Visy is a likely buyer. Should that occur, the initial acquisition

would give rise to aggregation in the market for PET bottle manufacture and supply in respect of Visy, and in addition, a minimal amount of aggregation would occur in the market for the manufacture of plastic pails.

15. Viscount Plastics (NZ) Limited, which has around [ ] % of the market for pails, advised the Commission that VIP's [ ] pails would represent around [ ] % of the market. To this extent, the Commission considers that the aggregation that will occur in any market for the manufacture and supply of pails is so minimal that it is unlikely to give rise to a substantial lessening of competition, and as such, the Commission will not discuss any such market further.

VisyPET (NZ) Limited, trading as VisyPak (Visy)

16. VisyPak is a member of a group of Visy Industries companies which are ultimately owned by Pratt Holdings Pty Ltd. An ownership structure diagram showing ownership of the companies interconnected with Visy (Pratt Group) is provided in Appendix 1.

17. Visy Industries was established in Melbourne, Australia in 1948 and has become one of the world's largest privately-owned paper recycling and packaging companies. Visy Industries' total manufacturing revenues exceed $2.5 billion and total manufacturing assets exceed $3 billion.

18. In February 2001, Visy Industries acquired Southcorp Packaging, now named Visy, which manufactures and supplies PET bottles and jars, aluminium and tinplate cans, paperboard cartons and rigid plastic packaging.

19. Visy is Visy Industries' New Zealand PET beverage container manufacturing operation, with production facilities in Auckland and Christchurch. Both operations produce a range of PET beverage containers, ranging in size from 390ml to 2.25l that are used for both carbonated soft drinks (CSD) and water. Visy is the preferred supplier of CSD bottles to Coca-Cola Amatil Limited (CCA). [ ].

ACI Operations NZ Limited (ACI)

20. ACI is a New Zealand company wholly-owned by Owens-Illinois (NZ) Limited, which is owned by ACI International Pty Ltd. ACI International Pty Ltd is ultimately owned by Owens-Illinois Inc, a publicly-listed company in the United States.

21. ACI has two manufacturing plants: one in East Tamaki which is the major administrative and manufacturing facility, and the Christchurch plant which manufactures PET containers only. In addition, it has three warehouses located in Christchurch and Wellington.

22. ACI manufactures and distributes a range of plastic packaging products. These products can be divided into five categories:

- PET beverage containers (including warm-fill and hot-fill) for CSD, water, juice and isotonics;

- PET food containers which are used for applications such as peanut butter and honey containers;
- Closures, which are the tops that seal the PET container products. They include CSD, water and juice bottle closures, hot-fill closures, and non-beverage closures. ACI manufactures non-beverage closures (which can be either standard or tamper-evident), but imports beverage closures for CSD, water, juice and isotonics from ACI Plastics Packaging Pty Limited;
- Rigid wall plastic pails that are used to contain paints, chemicals, food and inks. They are manufactured to be leak-proof with an air-tight seal, drop-resistant and resistant to environmental stress cracking; and
- Crates, which includes bins and tote boxes that are used for milk, produce, general storage, pharmaceutical, fish and meat storage and home storage. The crates are made from high density polyethylene (HDPE) and polypropylene.

23. In respect of non-alcoholic PET bottles, ACI's major customers are Frucor (*Pepsi* and *H2Go*) and Murdoch Manufacturing (house brands for Foodstuffs). In addition, ACI supplies water bottles to DB and tops up TSL's capability to supply Bevpac.

OTHER RELEVANT PARTIES

PET Bottle Manufacturers

Amcor Packaging (New Zealand) Limited (Amcor

24. Amcor is a global packaging company with annual sales of approximately NZ$12.5 billion. It is based in Australia and has operations throughout Australasia, Asia, Europe and the Americas. Amcor produces a range of plastic, fibre, metal and glass packaging products, PET containers, plastic and metal closures, along with packaging-related services. This includes, in New Zealand, the manufacture of PET bottles and aluminium cans. Amcor has a 31% share of the global PET market.

25. In New Zealand, Amcor has tended to specialise in warm and hot fill bottle production technology but also has the capability to manufacture ambient fill bottles. Amcor manufactures *Mizone, G Force*, 3litre *Citrus Tree*, *Just Juice* and *Freshup* bottles for Frucor, and *Powerade* bottles for CCA.

Alto Plastics Limited (Alto)

26. Alto is a privately owned company that specialises in injection moulding, blow moulding and injection stretch blow moulding production for PET products. Alto has tended to specialise in warm and hot fill technology, having CCA's contract to supply all of its juice and E2 bottles. [

].

TSL Plastics Limited (TSL)

27. TSL is a manufacturer and supplier of PET bottles to soft drink and water bottling companies, as well as to the spirits and liquor industries in New Zealand. TSL supplies up to [ ] % of the PET requirements of its vertically integrated downstream filler company, Bevpac.

Beverage Fillers

Coca-Cola Amatil (NZ) Limited (CCA)

28. The Coca-Cola Company (TCCC) is a global soft-drink manufacturer, based in Atlanta, USA. TCCC owns a number of soft-drink brands internationally. TCCC licences these brands to (mostly) independent bottlers in various territories, and produces beverage concentrates and syrups. TCCC also handles "big picture" promotional activities for its brands. All other activities are carried out by the licensed bottler in each territory.

29. In New Zealand, the licensed bottler is CCA. TCCC, through four subsidiary companies, owns [ ] of CCA.

30. TCCC brands in New Zealand are *Coca-Cola, Sprite, Fanta, Lift*, and *Lift Plus*, *Powerade*, *Pump* and *Hi-C*. TCCC also acquired the Schweppes brands in New Zealand in 1999. These are, *Schweppes, Roses and Sunkist*. In addition, TCCC purchased Rio beverages in 2002 and added the following fruit juice brands to its portfolio: *Keri*, *Pacific Orchard*, *Rio Gold*, *Robinson Brothers* and *Top Juice*.

31. CCA holds a number of brands itself that compete with TCCC and Schweppes brands. These include *L&P*, *Deep Spring*, and *Bubbly*.

32. CCA's current trademark/bottling agreement with TCCC commenced in 1995, [ ]. TCCC has an option to renew the agreement for [ ].

33. CCA is the largest participant in the market for the supply of non-alcoholic beverages with around [ ] % market share.

Frucor Beverages Group Limited (Frucor)

34. Frucor is a large New Zealand non-alcoholic beverage company, which was established by the Apple and Pear Marketing Board. In 1998 the company was sold to a consortium of financial investors led by United States based Pacific Equity Partners (PEP). In 2000 PEP sold 50.1% of Frucor through a public float. Frucor was subsequently purchased by the Danone group, the world's largest food and beverage manufacturer.

35. Frucor has brands in each of the main categories within the non-alcoholic beverage market. In the CSD segment it has the Pepsi range of products, in the fruit juice market it has *Just Juice, Fresh-Up,* and *Citrus Tree, Mizone* and *G Force* in sports drinks, V in energy drinks and *H2Go* and *Mizone* in water.

36. Frucor is the second-largest player in the market for the supply of non-alcoholic beverages with around [ ] % market share.

Bevpac NZ Limited (Bevpac)

37. Bevpac is the vertically integrated beverage filling operation of TSL, which predominantly fills house-brand CSDs, as well as its own "Jolly" brand. In addition, Bevpac fills the Pepsi range on behalf of Frucor.

PREVIOUS DECISIONS

38. The Commission has not previously considered the beverage packaging industry. However, in 2002 the Commission considered a matter in respect of the downstream beverage market when it gave clearance to The Coca-Cola Company Limited to acquire Rio Beverages Limited (Decisions Nos.480 and 481).

INDUSTRY BACKGROUND

The Non-alcoholic Beverage Industry

39. The non-alcoholic beverage industry in New Zealand is broad in terms of the breadth of product offered by suppliers to this industry. The products supplied by industry producers include: fruit juice, CSDs, mineral water, sports drinks or isotonics (such as *Gatorade, Powerade* and *Mizone*), and energy drinks such as (*Red Bull* and *V*).

40. The total size of this industry in terms of retail sales revenue is approximately $1.2b, with the CSD segment of the market the largest at approximately $695m, the juice segment approximately $210m, the water segment approximately $120m, the sports drink segment $65m, and the energy drinks segment approximately $120m.

41. Presently, there are two major participants in the industry; CCA, which has around [ ] % market share, and Frucor with around [ ]% market share.

42. According to the September 2003 FMCG magazine, the energy drinks and isotonics segment is growing at around 13% per annum.

43. Branding is a very important characteristic in this industry, as suppliers attempt to establish a point of difference for their products. The Commission was advised by Frucor and CCA that packaging is typically one of the first and most important considerations when they are developing new products. They also advised that higher margin products such as energy drinks, tend to be packaged in higher value packaging such as slimline cans and glass bottles.

44. The main distribution channels used are supermarkets, the route trade, vending machines and the "on-premise trade". General route trade includes dairies, takeaway stores, petroleum outlets, motels, and other general retail stores that stock beverages, such as video stores.

PET Bottle Production

45. PET (PolyEthylene Terephthalate) is a resin material. PET bottles are transparent plastic bottles typically used for packaging CSDs, water, sports and energy drinks and juice. PET grades used for soft drinks do not have sufficient oxygen resistance to ensure complete protection against deterioration in the taste of alcoholic beverages and nor are they able to be used for milk..

46. There are two distinct stages in the production of PET bottles:

    - the production of plastic preforms, the pre-production tubes used to make PET bottles; and
    - the production of empty PET bottles using the plastic preforms in specialised stretch blow-moulding machines.

47. PET preforms are injection moulded. The PET is extruded into a water-cooled mould, which consists of a neck section, core and cavity. The hot PET solidifies in the mould and forms the preform shape. The preform is then removed from the mould.

48. PET bottles can be produced either on single-stage machines or on two-stage machines. In the single-stage process, the two processes take place consecutively in the same production unit, whereby the preform, which is still warm from the injection moulding process, needs only to be thermally conditioned before being fed into the stretch blow-moulding chamber. In the two-stage process, PET preforms are produced on a separate production-line and afterwards blown into bottles on another machine.

49. One advantage of a two-stage process is that it yields a higher output per unit of time. Such a process is required for high volume runs such as those for CSDs. Visy has [ ] two-stage machines which are capable of producing around [ ] bottles an hour. ACI also has a two-stage machine, which is capable of producing around [ ] bottles an hour, as does Amcor whose two-stage capability is [ ] bottles per hour. Existing single-stage machines in the New Zealand market variously produce between [ ] bottles an hour.

50. However, although single-stage production is slower, operating multiple single-stage machines affords a PET bottle manufacturer the ability to conduct a variety of smaller runs simultaneously.

Barrier technology

51. For oxygen-sensitive products (such as beer), the gas barrier properties of a PET bottle need to be enhanced. One of the basic technical differences between PET and other materials used for beverage packaging is the fact that PET is gas permeable. To enhance the barrier properties of PET, a barrier technology is applied to the standard PET bottle. Barrier technology is either embedded in the material used for the preform, added to the preforms, or applied on the finished bottle.

52. This technology is relatively new and utilised for a limited number of alcoholic products. Miniature spirits bottles such as those found in hotel minibars, and the plastic beer bottles sold at entertainment and sporting events are examples of the limited use of PET for packaging alcoholic beverages presently.

Warm-fill and Hot-fill Technology

53. Warm-fill products are filled at around 74 degrees Celsius. Warm-filling is a non-aseptic method of packaging into PET, high acid drinks such as juices, in order to enhance their shelf life. Warm-fill bottles are typically thicker than standard PET bottles so that they can withstand the heat of the warmed liquid.

54. Hot-filling is a method of packaging into PET bottles, in which sterilisation is achieved by heating the drink to around 85 degrees Celsius and filling into the PET bottle at that temperature. Hot-fill bottles must also be thicker than standard PET bottles so that they can withstand the heat. In addition some hot-fill bottles have multiple contours such that the walls of the bottle do not collapse when the hot liquid is introduced. Sports waters such as *Mizone* are typically packaged in this way.

55. Warm and hot-filling has allowed for the packaging into PET of many more beverages than previously, and is presently a growth area of the PET bottle manufacturing industry.

56. Warm and hot-fill bottles are typically manufactured on different machines to those which manufacture ambient fill bottles, although ambient fill bottle production machines can be altered to manufacture warm and hot-fill bottles. Single-stage ambient-fill machines can be modified to produce warm or hot-fill bottles for less than $10,000. [ ]. However, the conversion of a two-stage machine from ambient to warm or hot-fill could cost between $500,000 and $1 million, as it would need to be retro-fitted with a heat set kit. Warm and hot-fill machines can and do produce ambient-fill bottles.

57. Amcor, Alto and ACI all have warm or hot-fill capability; Visy and TSL do not.

Aseptic Filling

58. Aseptic bottle filling is a process whereby pre-sterilised and treated products are filled into bottles that are sterile on the inside and are then sealed with closures that have also been sterilised. The filling process takes place in a sterile chamber within the filling machine. Typically juices that are packed into Liquid Paperboard cartons (LPBs) are handled aseptically, which requires a separate filling line from ambient, warm and hot filling lines. Aseptically-filled products have an enhanced shelf life and arguably a better taste than warm and hot-filled products.

Supply Agreement between CCA and Visy

59. CCA has entered into a contract with Visy for the supply of the majority of its PET bottles.

Term

60. [ ].

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ASSOCIATION

80. A preliminary question the Commission must determine is whether VIP and Visy are associated. Section 47(2) provides that, for the purposes of s 47(1), a reference to a person includes two or more persons that are interconnected or associated.

81. Sections 47(3) and (4) stipulate that two or more corporate entities are associated if one, either directly or indirectly, is able to exert a substantial degree of influence over the activities of the other. The Commission is of the view that, in this context, a substantial degree of influence means being able to bring real pressure to bear on the decision making process of the other.

82. VIP requested that the Commission consider the Application on the assumption that VIP is associated with Visy.[3] However, it is not clear from the Application whether the Applicant considered they were associated with Visy. In any event it is necessary for the Commission to come to its own view on the matter. In order to do so the Commission considered the details disclosed in the Application, met with the Applicant, representatives of VIP and Visy and other industry participants, and obtained information and documentation from those parties.

83. In coming to a view on association, the Commission must consider each case on its particular facts. Among the factors the Commission usually takes into account in determining association are the:

   - nature and extent of ownership links between the companies;
   - presence of overlapping directorships;

[3] Clearance Application, 22 March 2004, Para 5.10

- rights of one company to appoint directors of another; and
- nature of other shareholder agreements and links between the companies concerned.

84. The Commission also considers the interaction between these various factors. For example, the Commission assesses the nature and extent of the communications between persons, and the apparent influence of one person on the key strategic decisions of the other.[4] The question the Commission has to answer is whether two enterprises can, for the purposes of commerce and competition, be regarded as one.[5]

85. The Commission considers the following matters to be most relevant in considering whether VIP and Visy are likely to be associated:

Ownership and Family Links

- Raphael Geminder, chairman of VIP, is a director of 68 of Visy's Australian companies. All of those companies are tightly held, having only three directors in total. The other two directors are Richard and Jeanne Pratt, Mr Geminder's father-in-law and mother-in-law. There are no independent directors;
- none of Raphael Geminder, his wife Fiona Geminder (Richard and Jeanne Pratt's daughter), or their children own shares in any company in the Pratt Group. However, Mr Geminder advised the Commission that the extended family of Richard and Jeanne Pratt, of which Mr Geminder is a member, [ ];
- Mr Geminder is the sole director and shareholder of Salvage Pty Limited;
- [ ];
- in its application, the Applicant suggested that Mr Geminder does not participate in, and abstains from, any decisions that may create a potential conflict with the Salvage Group. While declarations of interest are made, it is not the practice of the Pratt Group to note abstinence from decision making. When interviewed by Commission staff, Mr Geminder said that this has never happened as he does not attend board meetings;
- there are no cross directorships or shareholdings between the VIP and Visy New Zealand companies but in all relevant cases the companies are wholly owned subsidiaries of companies within the Pratt Group or Salvage Group respectively; and

[4] Commission Decision No. 388: New Zealand Seafood Investments Ltd / Basuto Investments Ltd, Para's 16 – 24.
[5] Commission Decision No. 278: Air New Zealand Ltd/Ansett Holdings Ltd/Bodas Pty Ltd, especially Para's 180 – 182.

- the Commission understands that VIP [

  ].

Industry Perception

- The perception of industry participants, including Amcor and Alto, is that VIP and Visy act as one head in the market. During interviews, a number of industry participants referred to the entities as "Big Visy" and "Little Visy", and in fact David Frost, Regional Manager of VIP, himself made the reference. In addition, in an interview with Commission staff, [

  ]; and

- VIP bought its present plastic assets from Visy in June 2002 but as yet, does not have its own website. Further, Visy's website indicates that it still manufactures the products that VIP now makes. The Commission notes the advice of Visy that the website is at least 18 months out of date and needs to be updated. However, the Commission also notes the fact that the email addresses of VIP staff include the domain name visy.com.au and the lack of separation from a marketing perspective create the impression of VIP and the Visy operation being part of the same group. The Commission accepts that [ ], but notes that no effort has been made to distinguish VIP from Visy through a separate website or domain name. This adds to the public perception that Visy and VIP are one and the same entity.

Coordination and Mutual Cooperation

- At the time VIP purchased its present plastic assets from Visy, the parties entered into a [ ] Agreement". This agreement provides [

  ];

- Anecdotal evidence suggests that Visy's sales reps in New Zealand market products on behalf of VIP. Visy acknowledges one such example occurred with respect to an introduction by Mark Sargent, a member of Visy Carton Systems' sales staff;

- Visy also assists VIP with procurement of manufacturing inputs. VIP advised that it negotiates with suppliers in the first instance but that as it doesn't yet have sufficient "negotiation skills", Visy will often complete negotiations on VIP's behalf. Visy stated that it does negotiate supply arrangements for VIP but that it does not sign supply agreements on behalf of VIP; and

- [

].

86. The Commission must stand back and look at all the facts against the relevant statutory test. In this case it considered the interaction between the factors set out above in the context of the totality of the relationships between VIP and Visy. The Commission notes in particular the existence of companies held closely in one family, Mr Geminder's directorships of the Visy companies, industry perception that the companies are linked, and the approach of co-ordination and mutual co-operation adopted from time to time. In the opinion of the Commission, having taken all relevant factors into account there is a strong community of interest between VIP and Visy.

87. While none of the above factors is in itself necessarily determinative, when taken together, the Commission is of the view that VIP and Visy can, for the purposes of commerce and competition, be regarded as one.

88. Accordingly, the Commission intends to proceed with the competition analysis of the acquisition on the basis that the parties are associated and act as "one head" in the market, in order to determine whether the acquisition by VIP of the plastics packaging business and assets of ACI would have, or would be likely to have, the effect of substantially lessening competition in any of the relevant markets.

MARKET DEFINITION

89. The Act defines a market as:

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

90. For competition purposes, a market is defined to include all those suppliers, and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.[6]

91. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the five dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

92. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. For each initial market so defined, the Commission considers whether the imposition of a SSNIP would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market.

93. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market. The degree of demand-side substitutability is influenced by the extent of product differentiation.

94. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

95. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no

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[6] Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association*, above note 10; *Telecom Coporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 (reversed on other grounds).

additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

96. The Applicant submitted that there are two markets in which there will likely be an aggregation of business activity as a result of the proposed acquisition:

- the market for the manufacture and wholesale of large plastic pails; and
- the market for the manufacture and wholesale of all non-alcoholic beverage containers being made from materials including glass, aluminium and PET, and used for CSD, water, juices, and isotonics.

97. As discussed previously, given the minimal aggregation in respect of pails, the Commission has considered the demand-side and supply-side factors of the second market definition only.

Beverage containers

98. The Applicant argued for a broad market definition with respect to beverage containers by contending that glass, aluminium, PET, and in some cases liquid paperboard cartons (LPB) and high density polyethylene (HDPE), are readily substitutable packaging materials for most non-alcoholic beverage types.

99. For instance, CSDs are currently packaged in PET bottles, aluminium cans, and glass bottles. Water is packaged in PET, glass, and HDPE bottles. Juices are found in warm-fill PET bottles, aluminium cans, glass bottles, LPB cartons, and HDPE bottles. Isotonics alone are currently packaged in one medium (hot-fill PET).

100. However, the Commission is aware of a number of factors that limit the substitutability of various packaging types under certain circumstances. In its investigation, the Commission consulted widely with beverage packaging manufacturers and fillers over the factors that determine the choice of packaging materials by fillers. Three key factors were consistently identified:

- the retail distribution channel being targeted;
- the wholesale cost of packaging; and
- the nature of the beverage being packaged.

The discussion below elaborates on each in turn.

<u>Distribution channels</u>

101. The retail distribution channels used by fillers in New Zealand may be classified broadly into two categories: the supermarket channel and the route trade (petroleum outlets, convenience stores, and corner dairies).

102. Industry participants have submitted to the Commission that beverage products distributed through the supermarket channel are designed more for home consumption, in contrast to route trade products, which are designed for occasional consumption.

103. Fillers have suggested to the Commission that the packaging needs of customers consuming at home are different to those consuming occasionally and on-the-go, so different packaging types are used depending on whether the end product is destined for the supermarket or the route trade.

104. For instance, supermarket channel beverage products are generally sold in larger volume units so customers tend to seek light-weight packaging that facilitates easy storage (for example, LPB cartons and PET bottles that are designed to fit easily in refrigerators). [

].

105. Route trade customers tend to prefer packaging that offers functionality and ease of use (for example, resealable closures or small single-serve cans for on the-go-consumption).

106. The occasional nature of route trade consumption tends to favour beverages with a premium quality image. Route trade customers therefore tend to be willing to pay more for more costly packaging that enhances the premium image of the product (for example, glass bottles) than supermarket customers. [

].

107. Given that there are two retail channels that fillers use to distribute their beverage products, and that the packaging needs of the customers serviced by these two channels are sometimes quite different, the number of substitutable packaging options available to fillers is likely to be more limited than indicated by the Applicant. For instance, fillers are unlikely to consider using glass packaging, which is both heavy and expensive, for 3 litre juice products commonly found in supermarkets. Similarly, PET is a highly unlikely substitute for glass, for packaging energy drinks such as V or Lift Plus, which are branded as premium beverages in order to create a point of difference from regular CSD beverages, commonly packaged in PET.

108. The Commission recognises that the choice of distribution channel plays a role in determining the level of substitutability between different beverage packaging materials, and takes this factor into consideration when framing its definition of the relevant product market.

<u>Cost of packaging</u>

109. The Applicant submitted that:

> The demand for different beverage containers by fillers is a reflection of the demand for different beverage containers by end consumers. This is less a reflection of the price of each container and more a reflection of {marketing...; and functional characteristics…}.

110. However, the views expressed by fillers to the Commission suggest that the wholesale cost of beverage containers is a significant consideration when deciding on packaging material.

111. For instance, it was submitted to the Commission that while glass possesses many of the desirable characteristics for packaging water (clear containers, resealability), the high cost of glass in relation to PET makes it prohibitively expensive as a packaging option. Only imported premium waters, such as *San Pellegrino*, that retail at a price significantly higher than domestically bottled water, are sold in glass in New Zealand.

112. Hence, even in the face of a ssnip of 5-10% on the price of PET bottles, substitution away from PET towards glass would be unlikely to occur. Therefore, the Commission concludes that, for the purposes of the present application, glass would not fall within the same market as PET beverage packaging.

113. The ssnip test is less informative over the substitutability between aluminium cans, LPB cartons, and PET as beverage packaging options since the cost to fillers of these materials are relatively similar, yet most industry participants submitted that these should be excluded from the relevant market. In order to form a view about the substitutability of these materials, the Commission examined the applicability of alternative packaging materials to different beverage types.

<u>Beverage type</u>

114. Industry participants have confirmed the Applicant's submission to the Commission that, from both a product characteristic and marketing standpoint, the degree of demand-side substitutability between packaging types depends on the nature of the beverage being packaged. For instance, LPB and HDPE are unsuitable for packaging CSD due to their lack of carbonation retention. Water is often packaged in clear containers such as PET bottles (sometimes with a light blue tint) to capture the 'pure' water image. Juice products are generally not packaged in aluminium cans (with the exception of the Fresh Up brand, which has an iconic image in cans in New Zealand) since this packaging type is most commonly associated with CSD or beer. Isotonics (sports drinks) are packaged in hot-fill PET bottles that have resealable sipper-top closures for on-the-go consumption, a feature not offered by cans.

115. The Applicant argued that it is possible to influence consumers' tastes in beverage packaging through remarketing, in order to facilitate switching towards more cost-effective packaging materials:

> …end consumers' tastes and preferences can be swayed by marketing and placement of the particular product…if the merged entity was to raise prices, the fillers would be able to influence end consumers' demand through marketing and therefore effect a switch from PET bottles to glass bottles or aluminium cans.

116. While acknowledging the ability of fillers to remarket product in alternative packaging in response to rising input costs, the Commission recognises that this is likely to be an expensive exercise to undertake in most instances.

117. Generally, successful product positioning is only achieved after large amounts of money are sunk into vigorous and expensive marketing campaigns. Distinctive packaging is often used to differentiate beverage products and create a desired image. Substituting away from packaging strongly associated with a previously

established image is likely to require fillers to incur significant marketing expense in order to reposition the product. The potentially large sunk costs associated with remarketing products in alternative packaging may be a significant hurdle for fillers to overcome in order for smooth substitution to occur between beverage packaging materials. The Commission is of the view that this may in turn limit the degree of substitutability between beverage packaging materials.

118. Hence, the Commission recognises that certain materials are more suited to packaging certain beverage types, both from a marketing and technical application standpoint. In particular, for the purposes of the present application, the Commission is of the view that aluminium cans, LPB cartons, and HDPE bottles are unlikely to fall in the same product market as PET beverage packaging.

119. In addition, the Commission considered whether the relevant product market should encompass the packaging of alcoholic beverages and milk. PET beverage bottles in New Zealand are used almost exclusively for containing CSDs, water, juice and isotonics. For the following reasons there is very limited, or no, use of PET bottles for beer or milk (or any other liquid food).

120. Traditionally, beer and other alcoholic beverages have not been packaged in PET due to technological barriers. Although this is now possible (through the use of multi-layer preforms, heavyweight bottles, or coated bottles), consumer acceptance remains low. To date, production for beer has been limited to promotions and for event venues where glass is not permitted at the location.

121. Milk (which is considered by industry participants to be a liquid food rather than a beverage) is not packaged in PET because HDPE (which can contain milk but not CSDs due to carbonation retention qualities) is cheaper than PET, and PET bottles are unable to be manufactured with a moulded handle (current consumer preference is for milk bottles which incorporate a handle).

122. Hence, for the purposes of this application, the Commission considers that packaging for alcoholic beverages and packaging for milk are to be excluded from the scope of the relevant product market on the basis that PET bottles are not typically used to contain either product.

Hot-fill vs. Cold-fill

123. The Commission has considered whether cold-fill, warm-fill, and hot-fill bottles should be defined within the same product market. Given that warm and hot-fill machines are capable of manufacturing cold-fill bottles (after some relatively simple and costless retooling), and that single-stage machines can be converted to warm and hot-fill production relatively cheaply by incurring a one-off conversion cost of approximately [ ], the Commission is of the view that supply side substitution may occur reasonably readily and therefore, for the purposes of the present application, that cold, warm, and hot-fill bottles are likely to be in the same product market.

Conclusion on Product Market

124. Following its consultation with industry participants, for the purposes of the present application, the Commission is of the view that the relevant product market is narrower than a market for the manufacture and wholesale of all containers, as contended by the Applicant.

125. In addition, the Commission considers that bottles for alcoholic beverages and for liquid foods do not form part of the relevant market. However, the Commission considers that cold, warm and hot-fill bottles do all fall within the relevant market.

126. In carrying out its competition analysis, the Commission will take a conservative approach by adopting a narrow definition of the product market. Specifically, for the purposes of the present application, it is the Commission's view that the relevant product market in terms of beverage containers is PET bottles for non-alcoholic beverages.

127. The Commission recognises that if it can be satisfied through the competition analysis that the proposed acquisition will not lead to a substantial lessening of competition under this narrow market definition, then it would also be satisfied under any broader framing of the relevant market.

Functional Market

128. The production, distribution, and sale of a product typically occur through a series of functional levels, conventionally arranged vertically in descending order. Generally, the Commission identifies separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each.

129. Currently, all producers of PET bottles in New Zealand (converters) are manufacturers who supply the firms (fillers) that wholesale the packaged beverage to retailers (the supermarket and route trade). Hence, the Commission is of the view that the relevant functional market is the manufacture and supply of non-alcoholic beverage PET bottles.

Geographic Market

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

131. As discussed previously, the majority of contracts for the supply of PET beverage bottles in New Zealand are won through tender processes. Fillers put out an open tender on which converters submit bids. The two largest fillers in New Zealand, CCA and Frucor, both have filling plants located in Auckland and Christchurch. The geographic spread of these plants allows economical distribution of filled products throughout the North and South Islands, respectively. Similarly, two converters (ACI and Visy) also have plants in Auckland and Christchurch, allowing easy delivery of converted PET bottles to the fillers.

132. The wide geographic spread of some converters might suggest separate geographic markets in the North and South Islands. However, following industry-wide

consultation, the Commission understands that fillers do not put out regional tenders, and nor do converters submit regional bids. To the contrary, converters submit bids that are reflective of a national price for PET bottles. The existence of national prices, and the absence of regional bidding, strongly suggests the existence of a national market for PET bottles.

133. Furthermore, separate geographic markets could only exist if the distribution costs incurred by converters were sufficiently large to drive a wedge between the prices paid in different geographic regions. Such a wedge would prevent an arbitrage mechanism occurring whereby prices would be equalised across different geographic spaces through market forces. However, freight charges do not appear prohibitively large. For instance, currently Visy, the largest producer of PET bottles in the industry, [ ]. This lends further weight to the notion of a national market for PET bottles.

134. On this basis, the Commission concludes that the relevant geographic market for the manufacture and supply of PET bottles is a national one.

Conclusion on Market Definition

135. The Commission concludes that the relevant market for the purpose of analysing the proposed acquisition is:

- the national market for the manufacture and supply of PET bottles for non-alcoholic beverages.

COUNTERFACTUAL AND FACTUAL

136. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a "with" and "without" comparison rather than a "before" and "after" comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[7] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

137. VIP has bid for ACI's plastics businesses in Australia, although it has not bid for the PET division of the business in Australia. VIP advised the Commission that its reason for pursuing the proposed acquisition is to enable it to expand its operations in both New Zealand and Australia.

138. In its application, VIP stated at para.10.2:

> Following the acquisition, VIP currently intends to on-sell the two stage PET manufacturing assets, subject to receiving a commercially acceptable offer for those

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[7] Commerce Commission, *Decision 410: Ruapehu Alpine Lifts Ltd/Turoa Ski Resorts Ltd (in receivership), 14 November 2000*, paragraph 240, p 44.

> assets. VisyPET (NZ) Limited is a potential buyer for the two stage PET equipment and VIP has entered into discussions with Visy. VIP stated that it does not currently have the expertise to manufacture two stage PET beverage containers.

139. In the factual scenario, the Commission considers that VIP would operate the rigid packaging and single-stage PET operations of ACI as a single entity, and that it would on-sell ACI's two-stage assets to Visy, which would combine those assets with its own to be one of four competitors in the PET market.

Counterfactual

140. ACI advised Commission staff that [

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141. The Commission is unsure whether acquisition by other parties would give rise to competition concerns, so, for the purposes of this particular fact circumstance, the Commission is of the view that the more conservative position to adopt in framing the counterfactual for the purposes of competition analysis is that of ACI continuing to operate its PET assets.

142. Accordingly, for the purposes of this proposition, the Commission considers that the appropriate counterfactual is the status quo.

COMPETITION ANALYSIS

Existing Competition

143. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors). Supply-side substitution by near competitors arises either from redeployment of existing capacity, or from expansion involving minimal investment, in both cases involving a delay of no more than one year.

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

145. The Commission identifies market shares for all significant participants in the relevant market. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used.

146. An aggregation that would result in a low concentration level is unlikely to be associated with a substantial lessening of competition in a market. On this basis, indicative safe harbours may be specified.

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

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

148. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market. Specifically, the Commission seeks to understand the dynamics of the competition that would exist between the remaining firms in the market, compared to what would exist in the absence of the merger.

PET Bottles

149. Presently, there are four major manufacturers and one small manufacturer of PET bottles in the New Zealand market: Visy, ACI, Amcor, and Alto, with TSL being the fringe player. The proposed acquisition would reduce the number of players in the market from five to four, with one of those players being a fringe player.

150. Table 1 shows the manufacturers supplying each beverage filler.

Table 1: Suppliers of PET Bottles to Beverage Fillers

Beverage Filler	Owner	Current supplier
Coca-Cola Amatil (NZ) Limited (CCA)	Listed	Visy (CSDs and water) / Alto (juice sports drinks/isotonics)
Frucor Beverages Limited	Danone	ACI (CSDs and water), Amcor (isotonics and juice)
Bevpac NZ (1996) Limited (House brands)	Privately owned	TSL
DB Breweries Limited (House brands and water)	Listed	Amcor
Yeoman Industries Limited (House brands)	Privately owned	Amcor
Murdoch Manufacturing Limited (House brands)	Foodstuffs (South Island) Limited	ACI
Other		ACI/Alto

151. The Applicant submitted market share numbers based on production units in millions. These are set out in Table 2 below.

Table 2: Market Shares by Annual Sales (millions of units)

Rank	Manufacturer	PET	%
1	**Visy**	**[ ]**	[ ]
2	**ACI**	**[ ]**	[ ]
	Combined Entity (Visy /ACI)	**[ ]**	**[ ]**
3	**Amcor**	**[ ]**	[ ]
4	**Alto**	**[ ]**	[ ]
5	**TSL**	**[ ]**	[ ]
	Total	**[ ]**	**100%**

152. On the basis of these figures, presently Visy has a [ ]% market share and the three firm ratio is [ ]%. Immediately following the acquisition, the combined entity would have a market share of [ ]% and the three firm ratio would be [ ]%. This is outside the Commission's safe harbours.

Contestable vs. Non-contestable Supply

153. The PET beverage packaging supply agreement between Visy and CCA [ ].

154. The Supply Agreement also concentrates the supply of a significant proportion, [ ]%, of all currently produced PET beverage packaging into a single supply arrangement between Visy and CCA.

155. In short, the supply agreement is [ ].

156. [ ].

157. [ ].

158. The Commission has considered applications for acquisitions in the past where vertical integration arrangements created a potential distinction between contestable and non-contestable supply. In *Goodman Fielder and Defiance Mills* (Decision No. 289, 1997), it was submitted to the Commission that the supply of flour by mills vertically integrated with bakeries was 'tied' supply and should therefore be excluded from the relevant market. The Commission found in that case that the ties between vertically integrated mills and bakeries were not unbreakable since evidence at hand suggested some ties may be broken or renegotiated at any time, and under some circumstances bakeries could seek flour from other suppliers if the tied flour supply was not competitive.

159. As a result, in that case the Commission concluded that:

> … it is appropriate to ignore the distinction between tied and free flour in defining the market, and to consider whether vertical integration with respect to tied flour is an impediment to competition in the market.[8]

160. [ ]

> [ ]

161. [

[8] Commerce Commission, Decision 289: *Goodman Fielder and Defiance Mills*, 14 April 1997, paragraph 64.

].

162. Consequently, the Commission is of the view that the non-contestable supply of PET beverage packaging facilitated by the Agreement should not be considered part of the relevant market.

163. Given that Visy has no present market share based on production in the contestable market, assessing competition on the basis of actual production may not highlight any potential competition concerns to which this acquisition may give rise.

164. The ability to compete in the PET market is dependent on the respective total capacity of market participants. Therefore, the Commission is of the view that the total capacity for the manufacture of PET beverage packaging should be used as the base for assessing market share.

165. Visy has a total capacity of [ ], however [ ] of those units are committed to its non-contestable contract with CCA. The capacity that Visy has available to the contestable market is therefore [ ].

166. Each of the remaining players has their entire useable capacity available to the contestable market. Production capacity of market participants is estimated in Table 3.[9]

Table 3: Production Capability of PET Market Participants

Company	**Total capacity in millions of units**	**%**
Visy	[ ]	[ ]
ACI	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
Amcor	[ ]	[ ]
Alto	[ ]	[ ]
TSL	[ ]	[ ]
Total	**[ ]**	**100**

167. On the basis of these figures, presently Visy has [ ]% of the capacity available in the market and the three firm ratio is [ ]%. Immediately following the acquisition, the combined entity would have a market share of [ ]% and the three firm ratio would be [ ]%. This is outside the Commission's safe harbours.

[9] The Commission assumes, for the purpose of defining the relevant product market and carrying out its competition assessment, that the industry-wide stock of sunk capital remains constant (ie no new investment takes place) over the next two years since [ ]. Investment in new capital would increase total usable capacity.

168. Beverage fillers advised the Commission that contracts for the supply of PET bottles are keenly contested between existing participants, although TSL presently concentrates on supplying Bevpac. Further, they stated that there is a significant degree of competitive tension in the market with Amcor, Alto and ACI having tendered competitively for contracts in the past 12 months.

169. In addition, [ ].

170. [ ].

Current Production vs. Capacity

171. One driver of competition in this market is the significant amount of usable excess capacity of the market participants.

172. As technology has advanced, the production capacity of PET manufacturing machines has increased significantly. As a result, each of the market participants has considerable excess capacity, as shown in Table 4.

Table 4: Estimated Excess Capacity in the PET Market

Company	Total capacity in millions of units	Production	Excess Capacity
Visy	[ ]	[ ]	[ ]
ACI	[ ]	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**	**[ ]**
Amcor	[ ]	[ ]	[ ]
Alto	[ ]	[ ]	[ ]
TSL	[ ]	[ ]	[ ]
Total	**[ ]**	**[ ]**	**[ ]**

173. The Applicant submitted to the Commission that in the face of a sufficient price increase, industry-wide production could be readily scaled up by filling the excess capacity on currently underutilised machinery.[10]

174. The Commission recognises that there are likely to be costs associated with switching between different production runs when filling excess capacity on currently operational machinery. The most significant of these are likely to be technical labour costs associated with retooling machines and changing blow moulds, and the opportunity cost of halting production in order to retool.

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[10] *VIP/ACI Notice to the Commerce Commission Seeking Clearance*, 22 March 2004, paragraph 18.1

175. However, following extensive consultation with industry participants, the Commission understands that these switching costs are, in most instances, likely to be small relative to the value of the switched production. For instance, [ ] estimates switching times of 2-3 hours to change blow moulds and 3-12 hours to retool its injection moulding machines to produce preforms. On average, its cost of utilising technical labour, and opportunity cost of halting production, is approximately $80 an hour, so its estimated total cost of switching production runs is in the order of $240 to $960 each time.

176. Similarly, [ ]. Accordingly, the Commission considers that retooling time is not so significant as to have a material effect on the ability of respective players to compete.

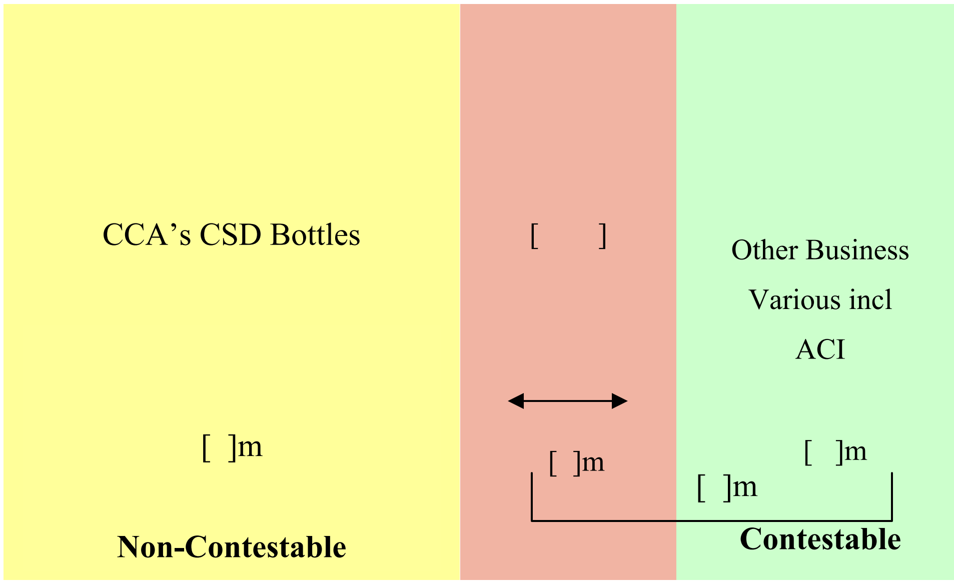
177. The supply agreement between Visy and CCA has given rise to some unusual dynamics in the PET bottle market and these are discussed more fully below. The Commission points out that the proposed acquisition will not create those dynamics. Accordingly, the ensuing discussion of the market dynamics is for the purpose of explaining the present state of the market.

178. Presently, [ ].

179. In addition, [ ].

180. On the face of it, [ ] and the contestable market would be represented as in Diagram 1.

Diagram 1: Present Contestable and Non-contestable Business in the PET Market

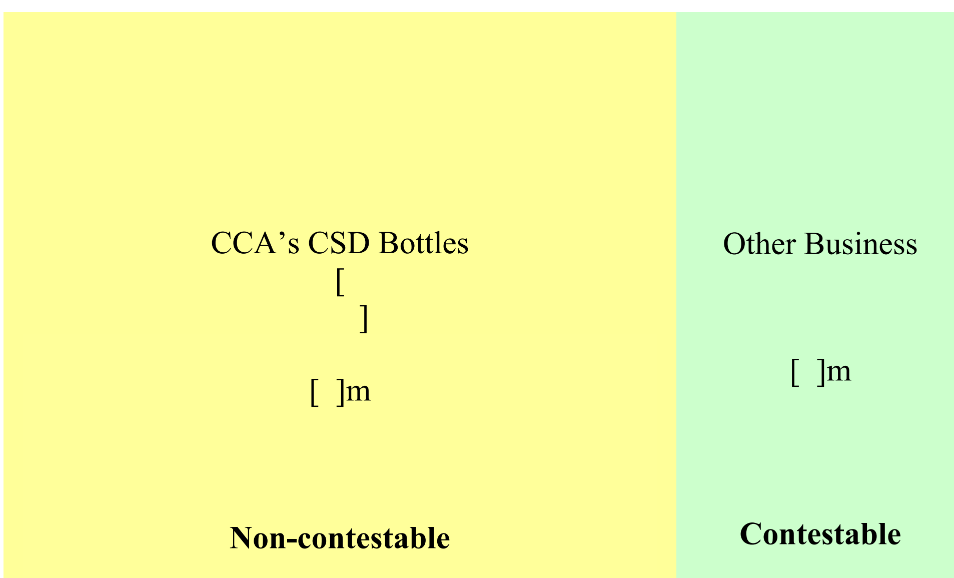


181. However, [

].

182. [ ] as shown in Diagram 2.

Diagram 2: Contestable and Non-contestable Business in the PET Market [ ]



183. In addition, post-acquisition, [ ]:

Table 5: Estimated Excess Capacity in the PET Market [ ]

Company	Total capacity in millions of units	Production	Excess Capacity
Combined entity	**[ ]**	**[ ]**	**[ ]**
Amcor	[ ]	[ ]	[ ]
Alto	[ ]	[ ]	[ ]
TSL	[ ]	[ ]	[ ]
Total	**[ ]**	**[ ]**	**[ ]**

184. [ ].

185. In addition, in the event that the merged entity increased prices, [ ]. If [ ].

186. Further, [ ].

187. To this extent, the Commission is of the view that the excess capacity of existing competitors together with their ability to quickly expand further if required, would provide a significant degree of constraint on the merged entity's ability to raise prices post-acquisition.

Barriers to Expansion for Existing Competitors

188. Some industry participants submitted to the Commission that the potential resale of ACI's PET bottling assets to Visy could afford it the opportunity to "price-gouge in the lower end of the market", thereby creating barriers to expansion by existing players.

189. Any efficiencies enjoyed by Visy post-acquisition would only be a concern to the Commission to the extent that they represent barriers to expansion by existing competitors.

190. In determining whether any efficiencies gained by Visy as a result of the acquisition would create barriers to expansion by existing competitors, the relevant questions are:

- how much more (or less) efficient would Visy be relative to its current position, having absorbed ACI's assets and current supply volumes; and
- how efficient would Visy be post-acquisition, relative to other converters in the industry?

191. The extent to which increasing returns to scale and synergies might occur as a result of an acquisition and subsequent expansion of output depends on a number of factors:

- the level of integration that would occur between the two businesses. If the two businesses remained standalone operations with little sharing of infrastructure and resources, synergies would be difficult to generate;
- the extent of the removal of duplicated costs (e.g. transaction, monitoring, and production switching costs);
- the extent of specialisation of capital and labour that could be achieved through a scaling up of operations;
- the extent of increased purchasing power for production inputs as a means of lowering average variable costs; and
- the level of increase in output following the acquisition, relative to any cost savings.

192. Visy has submitted to the Commission that:

> [ ]

193. Visy submitted to the Commission that:

> [ ].

194. To that extent, [ ]. Visy anticipates that [ ]. Hence, [ ].

195. Visy anticipates that there are [ ]:

> [ ]

196. In addition, [ ].

197. However, Visy also expects that [ ]. In addition, Visy advised the Commission that it anticipates the relocation of ACI's machines will cost between $[ ].

198. Visy submitted that:

[ ];

and

[ ].

199. This suggests that [ ].

200. However, the Commission recognises that [ ].

201. The major variable input in the production of PET bottles is resin. [ ] The Commission understands that [ ].

202. However, to date [ ].

As such, it appears that Visy would not gain any additional advantage over its competitors in respect of the purchase of resin as a result of the acquisition .

203. In order to attempt to make a judgement on Visy's returns to scale, both pre and post-acquisition, and relative to other converters, the Commission gathered data relating to the current cost structure of Visy, Amcor, Alto and TSL, as well as Visy's expected cost structure, assuming acquisition and full integration of ACI's PET beverage assets.

204. The data collected by the Commission relating to Visy's cost structure revealed that [ ]. However, the cost data pertaining to other firms in the industry was unable to be used by the Commission as a number of irreconcilable anomalies seemed to be present. Hence, the Commission was unable to quantitatively reach a view over the relative efficiencies of firms in the market, immediately following the acquisition.

205. To overcome this, the Commission adopted a qualitative approach and surmised that, if Visy currently enjoyed a significant cost advantage over its competitors, barriers to expansion would already exist for other players in the market.

206. In order to test this, the Commission collected recent bid prices from all market participants. The Commission found that customers such as Frucor have switched between PET bottle suppliers, and that further, Visy has bid for contestable business [ ]. As an example, the prices bid recently for the supply of Frucor's [ ].

207. Given that the merged firm is likely to [ ], post acquisition, the Commission is of the view that the acquisition would not create barriers to expansion for existing participants.

Conclusion on Existing Competition

208. The Commission is of the view that because of [ ], not all PET bottles produced in New Zealand should be included in the PET bottle market.

209. Further, the Commission considers that the measure of market share that would best highlight any potential competition concerns is capacity.

210. The proposed acquisition would see a reduction in the number of competitors from five to four, with one of that four being a fringe player. In addition, the Commission has assessed the implications of the existing supply agreement between Visy and CCA in an effort to determine the likely future dynamics of the PET market, absent the acquisition.

211. The Commission considers that Alto and Amcor are presently strong competitors [ ].

212. As a consequence, [ ].

213. In addition, the Commission has considered [ ]. In that event there would remain a significant amount of business in the market for which [

].

214. The Commission considers that if Visy already enjoyed significant efficiencies, these would represent barriers to expansion by other players presently. This does not appear to be the case. Further, post-acquisition, the combined entity is [

].

215. The Commission considers that the existing competitors have sufficient excess capacity to assume the combined entity's output in the event that it raised prices post-acquisition. Existing competitors also have the ability to expand quickly, if required, particularly if sponsored by a beverage filler.

216. Therefore, the Commission concludes that existing competition would provide a significant degree of constraint on the combined entity.

Potential Competition

217. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry.

218. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try. Where barriers to entry in a market are clearly low, it may be unnecessary for the Commission to identify specific businesses that might enter. In other markets, where barriers are higher, the Commission may seek to identify possible new entrants as a way of testing the assessed entry barriers.

Barriers to Entry

219. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market. The Commission is of the view that a barrier to entry is best defined as anything that amounts to a cost or disadvantage that a business has to face to enter a market that an established incumbent does not face.

220. The requirements for entry to the PET market are:

- production machinery;
- a source of resin; and
- a source of business.

221. Two stage PET bottle manufacturing machines cost in the vicinity of $5 million dollars each; presently Visy has [ ]. Visy stated that it [

]. Single stage machinery, which is also used for the production of PET bottles can be purchased new for around $1million.

222. There appears to be a market for second-hand machinery and given the excess capacity in the industry worldwide, prices are low compared to the price of new machinery.

223. [

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224. The Applicant submitted that just as non-beverage PET machinery can be converted into PET bottle production, so can a PET bottle machine be converted to produce other PET products. The Commission was advised by PET bottle manufacturers that while both of these statements are true, it is unlikely that the conversion of the beverage machinery to produce non-beverage containers would be cost-effective.

225. The Commission is advised by industry participants that resin can easily be sourced in New Zealand from a number of importers. In addition, it is possible to import resin directly, [ ].

226. Entry could be sponsored by a beverage filler such as CCA or Frucor. CCA sponsored entry when Visy entered the market by selling its PET bottle manufacturing assets to Visy and contracting with Visy for the production of its CSD requirements for a period of [ ]. However, the Commission notes that this sponsorship was [ ].

227. Similar sponsorship also occurred [

]. However, the Commission notes that in that instance, Frucor's sponsorship was of an existing competitor with an established reputation and was for the purchase of new technology.

228. As discussed in the section on existing competition, it is possible that [

]. In addition, there already exists significant excess capacity in the industry, which represents a strategic barrier to entering the PET bottle market.

229. In addition, securing a supply agreement with a beverage filler is likely to represent a significant barrier to entry for a de novo entrant, particularly as sales of PET bottles are lumpy due to the amount of contracted production in the PET bottle market.

Conclusion on Barriers to Entry

230. The Commission concludes that while second-hand machinery can be purchased at substantially reduced prices and resin is easily obtained, there exists a large amount of excess capacity in the PET bottle market, which is likely to represent a significant barrier to entry. In addition, obtaining supply arrangements with beverage fillers is likely to represent a significant barrier to entry for a new entrant.

The "LET" Test

231. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be Likely, sufficient in Extent and Timely (the LET test).

<u>Likelihood of Entry</u>

232. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power, and would not alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational business would be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

233. Post–acquisition there would be four players in the market. In the event that [ ] including the combined entity. [ ].

234. In addition, a new entrant would have to secure supply arrangements with beverage fillers. Contracts for PET bottle supply are typically for periods of [ ] years. As such, a new entrant is likely to have to enter in a piecemeal manner by bidding for contracts as they are tendered. Despite the fact that second-hand machinery can be easily obtained at substantially reduced prices, the Commission is of the view that a new entrant is unlikely to invest in machinery without supply contracts. On the flip-side, beverage fillers are unlikely to award contracts to a firm which does not have its operation established. Therefore, the Commission is of the view that de novo entry to the PET bottle market is unlikely.

<u>Extent of Entry</u>

235. If it is to constrain market participants, the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner.

236. As discussed above, a new entrant would have to wait for present supply contracts to expire before it could enter the PET bottle market. While the expiry of these contracts is staggered, the Commission is of the view that it may be difficult for a new entrant to secure sufficient supply contracts inside two years to warrant investment in PET bottle machinery. As such, the Commission is of the view that it may be difficult for a new entrant to gain sufficient business for it to be a credible threat to existing competitors.

<u>Timeliness of Entry</u>

237. If it is to alleviate concerns about a substantial lessening of competition, entry must be feasible within a reasonably short timeframe, considered to be two years, from the point at which market power is first exercised.

238. PET bottle machinery could be sourced quickly and installed inside 6 months. In addition, resin could be sourced inside this time. However, given the lumpy nature of sales in the PET bottle market, and the fact that supply arrangements are typically for periods of two to three years, the Commission is of the view that a new entrant may have to wait for two years or more before it is able to win sufficient supply arrangements to warrant the potential entrant's investment in machinery. Therefore, the Commission considers that it may be difficult for a new entrant to enter inside a two year timeframe.

Conclusion on Potential Competition

239. The Commission considers that barriers to de novo entry in the PET bottle market are so significant that de novo entry is unlikely. In addition, the Commission is of the view that a new entrant is unlikely to be able to effect entry on sufficient scale or within a reasonably short time-frame such that it would provide sufficient constraint on the merged entity.

Countervailing Power

240. The potential for a business to wield market power may be constrained by countervailing power in the hands of its customers, or when considering buyer market power (oligopsony or monopsony), its suppliers. In some circumstances, this constraint may be sufficient to eliminate concerns that an acquisition would be likely to lead to a substantial lessening of competition.

Countervailing Power of Suppliers

241. Prior to Visy's entry to the PET bottle market, CCA self-supplied. [ ].

242. [ ].

243. Further, [ ].

244. [ ].

245. However, [ ].

246. [ ].

247. Frucor advised the Commission that [

]. Frucor advised the Commission that its parent company, Danone, a global beverage supplier, has a policy of self-supplying its PET bottles in many other parts of the world. [ ].

248. In addition Frucor stated that [

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249. In addition, [

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250. Recently Frucor awarded a [ ] contract to Amcor for the production of its hot-fill *Mizone* bottles [ ]. This illustrates that Frucor is prepared to sponsor expansion.

Conclusion on Countervailing Power

251. The Commission considers that [ ] would provide a degree of constraint on the combined entity. In addition, Frucor would provide a significant degree of countervailing power on the combined entity through its ability to self-supply and also through its demonstrated ability to sponsor expansion.

Scope for the Exercise of Co-ordinated Market Power

252. Given the unusual dynamics that exist in this industry as a result of the existing supply agreement between Visy and CCA, the Commission has considered whether if [ ], the the scope for coordinated behaviour might exist in the PET bottle market

253. In order to assess such a possibility, the Commission adopted a number of hypothetical assumptions. Those assumptions are:

- that [ ];
- that [ ];
- that [ ];
- that there will then be [ ];
- that Visy and [ ] are incentivised to co-ordinate their behaviour; and
- that Visy and [ ] do co-ordinate their behaviour.

254. As the scope for coordinated behaviour was not found using the worst case scenario, the Commission did not assess the likelihood of these assumptions being realised.

255. When assessing the scope for co-ordination in the market, the Commission evaluates the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition.

256. The intention is to assess the likelihood that certain types of behaviour will occur, and whether these would be likely to lead to a substantial lessening of competition. In broad terms, effective coordination can be thought of as requiring three ingredients: the ability to co-ordinate behaviour, detection and retaliation.

Co-ordinated Behaviour

257. There are several features of market structure and behaviour that the Commission considers in assessing the likelihood of co-ordinated behaviour, these include:

- high seller concentration;
- undifferentiated product;
- static production technology;
- slow speed of new entry;
- lack of fringe competitors;
- acquisition of maverick business;
- price inelastic market demand;
- history of anti-competitive behaviour; and
- characteristics of buyers.

258. Presently, VIP, ACI, Amcor and Alto compete vigorously for business. Post-acquisition, Amcor and Alto would be the combined entity's main rivals. In the event that [ ].

259. [ ].

260. Further, [ ].

261. [

]. As such, competition could be significantly reduced so that prices for PET bottles would rise above competitive levels.

262. As tender and contract prices are not transparent, in order for the parties to collude on price, they would have to bid for all contracts to preserve the appearance of competition, but the designated supplier would have to tender the lower price in each case to be sure of winning. This would entail having to know each other's price, which would imply a detailed level of explicit collusion. Accordingly, the Commission is of the view that it is unlikely that the parties could easily co-ordinate on price.

263. Therefore, in order for, Visy and [ ] to co-ordinate their behaviour, they would require a way in which to divide the market, with a view to each raising prices in their respective market segments. Presently, [

].

264. While it may appear that the logical division is for Visy to supply CCA and for [

]. Over the [

].

265. Therefore, Visy would stand to be the loser in any market sharing arrangement, and as such the Commission considers it likely that Visy would continue to compete for contestable business in order to fill its capacity.

266. The price that CCA pays to Visy for the supply of its PET bottles is [

].

267. In addition, if CCA [ ]. Therefore, it is likely that [

].

268. Further, the contracts put to tender by fillers typically involve volumes in excess of 5 million units. As these are significant volumes, the resolve to adhere to any terms of a market sharing arrangement may be undermined.

269. PET technology is advancing, bringing the possibility of new non-alcoholic beverage products. Recent innovations include energy drinks and sports waters which were introduced due to innovations in hot-fill bottle technology. Presently the sports drink segment of the market is growing at 13% per annum. Barrier technology is also improving. As such, it is likely that both CCA and Frucor will devise new products in the near future. In this event, they would likely desire to go to the market for pricing on any such business.

270. Further a degree of product differentiation such as that between CSD bottles and hot-fill bottles aids in making co-ordination more difficult.

271. However, the possibility exists that [ ].

272. If that were the case, and if Visy and [ ] tendered for the business with high prices, it is possible that Frucor or CCA could approach [ ], Frucor has previously demonstrated that it is prepared to sponsor expansion. [ ].

273. As discussed in the section on countervailing power above, Frucor recently sponsored [ ]. Acquisition of any new technology is likely to incentivise the acquirer to compete for other business in order to fill available capacity and improve efficiency.

274. Any such expansion by [ ].

275. Frucor advised the Commission that it would be [ ].

276. At present, competitors are generally bidding for tenders at [ ].

277. In the event that Frucor invited both Visy and Amcor to submit bids, any attempt by Visy to 'throw' a bid would be visible to Frucor. As such, Frucor would have the option of sponsoring expansion or entry by another player.

278. Frucor also has the ability to self-supply. Frucor advised the Commission that its parent company Danone has a policy of self-supplying in other parts of the world and that [ ]. Given [ ].

279. However, as mentioned above, CCA has an interest in keeping prices down in the contestable market, [ ].

280. On the basis of these considerations, the Commission considers that it is unlikely that Visy and [ ] would have the incentive and/or ability to co-ordinate their behaviour in order to share the market, and that even if they did, it is unlikely that they would be able to sustain such an arrangement.

Detection

281. Detection requires that businesses that would deviate from the likely co-ordination are able to be swiftly detected by the other market participants involved.[11] The Commission is of the view that the ability of competitors to detect deviation is likely to be enhanced where the following market conditions apply:

- High seller concentration;
- Frequent sales;
- Lack of vertical integration,
- Stable/slow growth in demand;
- Cost similarities between businesses;
- Multi-market contact; and
- Price transparency.

282. In the situation where [ ]. An attempt by any party to deviate from any market sharing arrangement which the parties entered into would be instantly detectable, as one party or the other would either gain or lose contracts. In the event that [ ] bid for and gained a contract, both Visy and Frucor could easily discover this simply by asking the filler that put the tender to the market.

Retaliation

283. Deviations from the terms of co-ordination need to be not only quickly detected by the other suppliers, but also the deviating firm needs to be faced with a credible threat of swiftly being punished. The threat of retaliation increases the cost of deviating, thereby reducing the short-term profit to be gained by the business from deviating, and helping to preserve the co-ordination.

284. As previously noted, excess capacity abounds in the PET bottle market. As such, both Visy and [ ] have some ability to price low in order to fill their excess capacity, although [

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[11] Stephen Martin, Industrial Economics: Economic Analysis and Public Policy (2nd edition), New York: Macmillan, 1994, ch 6.

]. However, [ ], although any retaliation could be delayed given the infrequency with which contracts are tendered.

Conclusion on Scope for the Exercise of Coordinated Market Power

285. The ability of Visy and [ ] to co-ordinate their behaviour in order to share the PET bottle market rests largely on a set of assumptions including [ ], so that Frucor can ensure that there is some competitive tension in the market.

286. Presently, it seems unlikely that firms in the market have the ability to co-ordinate their behaviour given that supply contracts are being awarded to various market participants by beverage fillers.

287. [ ].

288. In the event, that [ ], Visy is unlikely to enter into any market sharing arrangement with [ ] on the basis of a Visy/CCA – [ ].

289. Further, because of its supply agreement with CCA, [ ], as it would erode Visy's position in the contestable market.

290. Although presently a [ ] to expand its operations to assume a share of the contestable PET bottle market, particularly if sponsored by Frucor, which has sponsored expansion in the past.

291. Accordingly, Frucor would hold a significant degree of countervailing power over both Visy and [ ] through its ability to sponsor a third player and also through its ability to self-supply, such that even in the event that Visy and [ ] did enter into a market sharing arrangement, it is unlikely that they could sustain any such arrangement.

292. Detection of deviation from any such arrangement would be easy for both Visy and [ ], although retaliation by Visy could be hindered by [ ]. However, any unilateral market power that [ ] might derive from such a situation would be tempered by Frucor's significant degree of countervailing power.

293. Therefore, the Commission is of the view that it is unlikely that Visy and [ ] would co-ordinate their behaviour in order to share the market and that even if they did, any such arrangement would likely be difficult to sustain.

OVERALL CONCLUSION

294. The Commission has considered the probable nature and extent of competition that would exist in the counterfactual in the national market for the manufacture and supply of PET non-alcoholic beverage bottles.

295. The Commission concludes that VIP and Visy are likely to be associated.

296. The Commission considers that the appropriate counterfactual in this case is the acquisition by another party, or ACI continuing to operate its PET assets, which is the status quo.

297. Presently, not all PET bottle business in New Zealand is contestable, and as such, the Commission considers it appropriate to consider the existing competition in the market for that business which is contestable. Accordingly, the Commission is of the view that competition in the PET market should be assessed on the basis of capacity available to the market. On that basis, the acquisition would give rise to a reduction in the number of participants in the PET bottle market from five to four. In addition, the combined entity would have a market share that is outside the Commission's safe harbours.

298. The Commission has also considered whether [ ]. The Commission is of the view that [ ].

299. The Commission considers that the existing competitors Amcor, Alto and TSL all have [ ]. In addition, they each have the ability and incentive to expand their operations quickly and easily if required, such that they would provide a significant degree of constraint on the combined entity.

300. Post-acquisition, the Commission is of the view that the combined entity is [ ].

301. The Commission considers that the excess capacity of existing competitors and the difficulty a new entrant would experience in securing supply agreements represent significant barriers to entry such that de novo entry to the PET bottle market is unlikely.

302. The Commission considers that [ ] would provide a degree of constraint on the merged entity. In addition, Frucor would provide a significant degree of countervailing power on the merged entity through its ability to self-supply and also through its demonstrated ability to sponsor expansion.

303. Further, the Commission is of the view that it is unlikely that Visy and [ ] would co-ordinate their behaviour in order to share the market and that even if they did, any such arrangement would be likely to be difficult to sustain.

304. On balance, the Commission concludes that, in the face of any attempt by the combined entity to raise prices, the existing level of competition, together with the ability of existing participants to expand, and the significant countervailing power of Frucor would be sufficient to constrain the combined entity. Therefore, the

Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for PET bottles.

305. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by VIP of the plastics packaging business and assets of ACI.

DETERMINATION ON NOTICE OF CLEARANCE

306. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Visy Industrial Plastics (NZ) Limited (VIP) of the plastics packaging business and assets of ACI Operations NZ Limited (ACI).

Dated this 26th day of May 2004

Paula Rebstock
Chair
Commerce Commission