

MEMORANDUM

**TO:** Troy Pilkington, Russell McVeagh  
**FROM:** Matthew Dunning  
**DATE:** 24 November 2020  
**SUBJECT:** PACT GROUP HOLDINGS LIMITED/FLIGHT PLASTICS LIMITED

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1. I refer to our discussions regarding an application for clearance from the Commerce Commission for Pact to acquire the assets and business of Flight.
2. Advice has been sought from me regarding that application, in particular the Commission's Statement of Issues ("**SOI**") dated 30 October 2020. Materials I have been provided relevant to that include:
  - (a) the application for clearance dated 25 August 2020;
  - (b) RFI responses dated 1 and 23 September 2020;
  - (c) cross-submission and submission dated 5 October and 19 October 2020 respectively, together with an email to the Commission dated 6 October 2020; and
  - (d) a NERA report also being submitted in response to the SOI.
3. The preliminary views being tested in the SOI appear to be that:
  - (a) the product market may be split in two: PET and RPET, and possibly three by reference to NZ RPET (yet there is no overlap between Pact and Flight in NZ RPET [ ]<sup>1</sup>,
  - (b) Pact and Flight are close competitors, and not only will that competition cease post-merger, but development by Pact of a wash plant in the counterfactual would no longer occur [ ],
  - (c) Pact and Flight are identified as two of the major suppliers of PET packaging, (yet so also is Custom-Pak), particularly when larger volumes are needed. [ ], and "imported PET packaging can be cheaper per-unit for customers than locally-produced PET packaging, if sufficient quantities are ordered".<sup>2</sup> Imports constitute at least [ ] of PET packaging supplied in New Zealand,

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<sup>1</sup> [ ].

<sup>2</sup> SOI, para 59.

- (d) larger customers might be able to exercise countervailing power, but might not be able to “protect smaller customers without such power”<sup>3</sup> (yet it is accepted that there are “many other suppliers with thermoforming capacity...[which] have spare capacity available to serve other customers”<sup>4</sup> ie, questions of scale do not inhibit competitive choice for smaller customers anyway),
- (e) if Pact builds a wash plant, it might compete with Flight for locally produced PET bales in the counterfactual and drive up their price (it is difficult to see why that would be pro-competitive, [ ]). At the same time, the SOI contemplates the possibility of at least one other rival being interested in building a wash plant, which presumably could equally compete and drive up the price if it were to do so),

whereas

in the factual the merged entity could drive down that price (again, it is hard to see why that would not be pro-competitive - a cheaper input cost should, in a competitive processing market, lead to cheaper PET roll stock and packaging. These concerns seem directed more at wealth transfers and/or ancillary benefits/disbenefits - similarly for the price it is speculated may be received by suppliers of PET offcuts [ ]<sup>5</sup> – and also do not appear to account for the influence on prices through being globally traded commodities), and

- (f) the merged entity may use all the NZ RPET that Flight produces and not supply its competitors (yet that would be no different from the current position), whereas in the counterfactual Pact may (a) build a wash plant [ ], (b) supply NZ RPET to the market (rather than use it as an input itself as Flight does and as the SOI suggests the merged entity would do too),<sup>6</sup> and (c) Flight would instead then start supplying NZ RPET to the market as well ([ ]<sup>7</sup>), or
- (g) even if Pact “would not be likely to compete to supply NZ RPET roll stock in the counterfactual”<sup>8</sup> it is worth considering whether Flight would be likely to start supplying NZ RPET roll stock anyway “due to an increase in available waste PET bales...and increased demand for NZ RPET roll stock and packaging generally”,<sup>9</sup> whereas “in the factual, the merged entity would have a decreased incentive to supply NZ RPET roll stock as it would have a larger customer base than Flight would have without the proposed acquisition”<sup>10</sup>,

(yet, even assuming increased availability of waste PET bales:

- (i) that would not necessarily lead to a surplus of NZ RPET roll stock in the hands of Flight anyway, given the equal assertion of increased demand

<sup>3</sup> SOI, para 65.2.

<sup>4</sup> SOI, para 58.1.

<sup>5</sup> [ ].

<sup>6</sup> SOI, para 78: “in the factual, the merged entity would have a decreased incentive to supply NZ RPET roll stock as it would have a larger customer base than Flight would have without the proposed acquisition”

<sup>7</sup> [ ].

<sup>8</sup> SOI, para 78.

<sup>9</sup> SOI, para 78.1.

<sup>10</sup> SOI, para 78.2.

for NZ PET packaging at the same time, which in the counterfactual Flight would [ ], or

- (ii) [ ],
  - (iii) which also assumes that in the counterfactual Flight would take it all and that this increased volume of waste PET bales would not be available directly to or contested by competitors, [ ],
  - (iv) nor can it be assumed in the factual that the postulated increased volumes of waste PET bales would be exactly matched by the merged entity's consumption of it or that only the merged entity would have access to the increased volumes, and so another rival as identified in the SOI could still pursue development of a wash plant in the factual in the assumed circumstances of "an increase in available waste PET bales"), and
  - (v) in any event, a second wash plant and further processing of RPET is not of itself the determinant of competition in this market, now or post-merger, given the apparent constraints from imports, other E&T suppliers, and packaging made with other substrates.
4. It is understood that these views are expressed in the SOI as being "preliminary" for "testing". However, to the extent they inform the approach to the Commission making its final determination it is obviously critical that those views are well informed and based on correct legal and economic principles in respect of:
- (a) market dimensions, dynamics and entry conditions, accounting for the competitive constraints actually occurring,
  - (b) counterfactual considerations, what the evidence indicates and what logically can be derived from it,
  - (c) access to inputs in a freely traded international market, and
  - (d) the apparently easy movement of materials into and out of the country illustrating the openness of our market and that imports are a highly significant feature here (at least [ ] of the market, conservatively estimated).
5. The SOI states that the participants appear to be close competitors<sup>11</sup> (the "two largest suppliers of PET packaging in New Zealand by volume of units sold...the merged entity will produce [ ] of E&T packaging"<sup>12</sup>) and the "primary concern is the loss of competition between Pact and Flight".<sup>13</sup>
6. Loss of competition between merger parties is axiomatic. It is also axiomatic that market shares are only a starting point and should not distract from the primary question of merger analysis, namely, what constraints will otherwise exist in the market to deter the merged entity from raising prices or decreasing output/quality to non-competitive levels? For the reasons that follow, given the evidence already provided to the Commission the SOI does not appear to reflect an appropriate focus in this regard.

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<sup>11</sup> SOI, para 53 et seq.

<sup>12</sup> SOI, para 55.1.

<sup>13</sup> SOI, paras 5 and 66.

**MARKET DEFINITION**

7. The definition of a market in s3(1A) of the Act is “a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.”
8. Substitutability is not a simple technical exercise. The *ssnip* test is an appropriate starting point for consideration of substitutability,<sup>14</sup> but the considerations in *Brambles New Zealand Ltd v Commerce Commission* should also be borne in mind.<sup>15</sup>
9. Application of “fact and commercial commonsense” is an important filter, and has informed the New Zealand approach from the beginning (*Edmonds Food Industries Ltd/W F Tucker Co Ltd CC Decision No 84*, 21 June 1984, at [3] and [7]):

In delineating the relevant market in any particular case there is a value judgment which must be made which involves, for example, an assessment of pertinent market realities such as technology, distance, cost and price incentives; an assessment of the degree of substitutability of products; an appreciation of the fact that a market is dynamic and that potential competition is relevant; and an evaluation of industry viewpoints and public tastes and attitudes. Particularly important in the process is industry recognition (both by supplier and purchaser) and recognition by the consumer. Ultimately the judgment as to the appropriate market — and its delineation by function, product and area — is a question of fact which must be made on the basis of commercial common sense in the circumstances of each case.

10. Ultimately, the potentially conflicting views here of market definition should not, in theory, alter the outcome (since either the evidence supports the broader market definition put forward by the applicant or, even if not accepted, RPET, NZ RPET and alternative packaging must be accounted for as competitive constraints on PET packaging, by application of the principles in *Brambles*), but it would be as well to avoid some of the distractions suggested by the SOI:
  - (a) if NZ RPET is a separate product market, Pact does not participate in it<sup>16</sup> and so there would be no aggregation per se [ ]. Yet the application is presented on the basis that NZ RPET is part of the relevant packaging market and so aggregation and competition concerns are effectively caught within the applicant’s market definition, and there seems to be little merit in the Commission pursuing a market definition with the distinctions the SOI seems to be seeking to make,
  - (b) emerging demand trends per se do not fracture a market into separate elements, just as innovations from suppliers generally do not either: more often they reflect a competitive dynamic within that product space,
  - (c) if trends towards sustainability are viewed in the SOI as separating RPET from PET, that would more logically put RPET in the same category as non-PET alternatives (ie, there would be a PET packaging market and a sustainable packaging market which included RPET), yet the evidence does not support that either. There appears to be abundant evidence of consumers treating all

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<sup>14</sup> Nera’s analysis in this respect would strongly support the applicants’ market definition.

<sup>15</sup> (2003) 10 TCLR 868 (HC) at [244].

<sup>16</sup> [ ]

packaging interchangeably regardless of substrate, with price being one relevant factor (the examples provided in section 5.16, 5.17 and following in the application speak for themselves. As an aside, this appears to be a general trend across all plastic packaging: Fonterra is supplying milk in plant-based containers, single-use plastic bags are on the decline and takeaway coffee container lids are increasingly compostable as well as their cup).

Probably the most telling commercial fact is that PET packaging manufacturers consider themselves under threat from alternatives, and that meeting the demand for those and competition from them is the rationale for the proposed acquisition.

11. So as a matter of fact and commonsense, there would seem to be every indication that the broader market contended for by the applicant is supportable.
12. If, however, that view is still not accepted, then *Brambles* is clear authority for the proposition that actual usage and the alternatives referred to in the application must be accounted for, and not be under-estimated, as competitive constraints. The circumstances of that case were not dissimilar to the present, and the decision warrants extensive citation. The court observed in respect of whether (re-usable) plastic crates and traditional (disposable) cardboard boxes were substitutes:

[93] The evidence in the record strongly suggests an evolution in produce packaging systems. There have been two important developments in recent years: the use of returnable systems as an alternative for one-way systems (cardboard in particular) and the displacement of wooden crates with plastic crates. Thus New Zealand has seen the development of a new product/service (plastic crates for hire) which has both supplanted and extended the product range. On the face of it, the market boundary has changed to exclude wooden boxes and to include plastic crates. Cardboard cartons appear to be the constant. Even if some irreversible substitution has occurred, there was nothing in the record to suggest that one-way carton use had virtually been phased out or that the Commission had extrapolated some observable trend that would change the counterfactual. Rather, there was evidence from wholesalers based on recorded data (to which we will refer later) showing continued usage of cardboard cartons – and not just for high value low volume items. Indeed, the Commission had adopted a packing systems market in previous investigations involving CHEP on the basis that disposable packaging systems could serve a similar function as, and were substitutable for, reusable packaging systems.

[125] The *ssnip* test does not however suggest that cost equivalence after a relative price change is a necessary condition for close substitutability. This is especially so when products are differentiated (as are crates and cardboard) and where there are agreed advantages and disadvantages of each. This means that absolute and relative prices are only one component of comparative value propositions.

[130] There was evidence that crates and cardboard boxes each have advantages and disadvantages, some of which are significant. The deposit system for crates and the need to pass on liability for the deposit through the supply chain is clearly a disadvantage. On the other hand, cardboard is not reusable and there is a need to arrange disposal. There are a great number of other aspects of both which affect buyer preferences, relating to capacity,

branding, stackability, strapping required on pallets, resistance to squashing, capital commitment required to buy cardboard or to pay crate deposits and so on. All of these indicate that in considering the "price-product-service packages" (to use the words of QCMA at p 515) in relation to differentiated products, it is unwise to concentrate solely on price.

[132]...It is appropriate to make a common sense assessment, based on the evidence before the Commission. Clearly, cardboard cartons and plastic crates are technical substitutes for most produce lines, and both are being used in the produce distribution chain at the moment. There are a variety of preferences for one or the other, based on grower or retailer preference and the particular requirements of the produce line, but there is considerable use of both for the same purpose.

Ultimately, it was acknowledged that the real issue was the degree to which cardboard was recognised as a competitive constraint, whether included within the product market or not, but the risk (which was realised there, the Court found) was that by not accounting for it as a substitute within the definition, the Commission under-estimated the degree of constraint.

13. Similarly here, in light of evidence of the industry background and experiences narrated in the application in sections 5 and 6.

#### **Wash Plant**

14. [ ]. In light of a contrary assertion by a competitor and an anonymous submitter, [ ]<sup>17</sup>, [ ]<sup>18</sup>, [ ] Accordingly, "it is incorrect to state that the Acquisition will result in any loss of competition in NZ-based wash plant or RPET production capacity".<sup>19</sup>
15. There also appears to be a degree of logical inconsistency in the SOI's approach to this question. The SOI implicitly queries [ ] especially given the SOI's apparent belief that there will be an increase in availability of RPET bales<sup>20</sup> [ ]<sup>21</sup>

#### **JUDICIAL APPROACH TO COUNTERFACTUAL**

16. Relevant case law has been cited by the applicants to the Commission at [22] of your 19 October 2020 submission. I have little to add to that accurate summary of the legal position, except to observe that in *Woolworths*:<sup>22</sup>
  - (a) the possibility of new entry was not hypothetical (whereas here it is[ ], because The Warehouse had already entered the market by rolling out some of its "superstore" concepts ("Extra"),
  - (b) the "forward looking" aspect for consideration was whether the concept was viable and would continue, and in respect of which the Commission took into account the business case evidence from the relevant party (and the Court of Appeal was "not prepared to second-guess the business judgment of the senior

<sup>17</sup> [ ].

<sup>18</sup> [ ]

<sup>19</sup> 5 October 2020 cross-submission, [19(a)].

<sup>20</sup> SOI, para 78.1.

<sup>21</sup> [ ].

<sup>22</sup> *Commerce Commission v Woolworths Limited* [2008] NZCA 276.

management and directors of the Warehouse”<sup>23</sup> (although in that case theoretical structural concerns posed by a 3:2 merger and high barriers to entry played a greater part in deliberations than they need to here).

The question, as the Court of Appeal made clear, is “whether there is a real and substantial prospect”<sup>24</sup> of something occurring in the counterfactual for it to be accounted for. [ ]

## ENTRY CONDITIONS/IMPORTS

17. As we know, whether a substantial lessening of competition is likely as a result of a merger generally equates to a question of market power: what will constrain the merged entity from being able to exercise it?
18. Merely having the largest share will not enable the merged entity to exercise power in this case, because:
  - (a) the SOI acknowledges Pact and Flight being “two of the main options” (ie, there are others), that “the main suppliers of PET in New Zealand are Pact, Flight and Custom-Pak”,<sup>25</sup> and that “Custom-Pak appears to [be] the next largest competitor and competes with the Parties in some (but not all) product categories. There are many other suppliers with thermoforming capacity. Some of these firms have indicated they have spare capacity available to serve other customers. However, these suppliers manufacture at a smaller scale than the parties.”<sup>26</sup>
  - (b) “whether the merged entity would be able to increase prices to smaller customers”<sup>27</sup> would not, therefore, seem to be a valid concern,
  - (c) barriers to entry and expansion appear to be low,
  - (d) constraint does not have to be complete (ie across all product categories) to be effective, and in every category only one or the other of the merger participants has a significant share, not both (ie, various rivals are active in all),
  - (e) the industry is also characterised by large, international players, operating globally with presences in the New Zealand market (including Sealed Air (Cryovac) - partnered with Bonson - Huhtamaki, Multisteps and Linpac),
  - (f) the trans-Tasman dimension is influential. Competition in Australia as a result of imports there and the capacity within its industry, creates “follow on” effects in New Zealand insofar as Australian customers of New Zealand producers have both New Zealand, Australia and further afield as competitive supply options. Equally, Australian producers can supply into New Zealand, Linpac supplies Woolworths NZ from manufacturing in Australia, for example,
  - (g) “imported PET packaging can be cheaper per-unit for customers than locally produced PET packaging”,<sup>28</sup>

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<sup>23</sup> At [142].

<sup>24</sup> At [135].

<sup>25</sup> SOI, [55.2.1] and [55.2.2].

<sup>26</sup> SOI, [58.1].

<sup>27</sup> SOI, [65.2].

<sup>28</sup> SOI, [59].

- (h) accordingly, the ability of larger customers to find alternatives and/or exercise countervailing power (which is only really an effective power if there are alternatives), is not an issue either, and
- (i) imports represent a very significant and conservatively estimated [ ] of the market (figures less than that were acknowledged as a constraint in the Commission's clearance of the carpet market merger in *Godfrey Hirst/Feltex*<sup>29</sup>).
19. In respect of imports specifically:
- (a) s3(3) of the Act states that "the effect on competition in a market shall be determined by reference to all factors that affect competition in that market including competition from goods or services supplied or likely to be supplied by persons not resident or not carrying on business in New Zealand",
- (b) the narrative to this industry, including the experience in Australia, reflects low barriers to entry and globally traded products at international commodity prices at a number of levels of the supply chain, including PET resin (numerous importers: PET resin is used in multiple formats, not just E&T and not just packaging), PET/RPET roll stock (Custom-Pak Aztec Packaging, Formrite for their own manufacture,), and finished packaging (for example, Linpac, Multisteps, Huhtamaki, Jenkins Freshpac, Oppenheimer, LeesPac, Benxon, etc).
- (c) product moves easily trans-Tasman. [ ] of Pact's New Zealand produced volumes are supplied into Australia [ ]. Custom-Pak sources roll-stock inputs from [ ], and Linpac satisfies one of New Zealand's largest customers (Woolworths) by imports of finished goods. Huhtamaki shut down its New Zealand operation and services its customers from its manufacturing operations in Asia.
20. Hence, and in conclusion, applying the QCMA<sup>30</sup> factors here:
- (a) the degree of concentration post-merger by reference to market share simpliciter would not be as high as many New Zealand industries, and there is a better distribution in number and size than would be found in many,
- (b) barriers to entry (and expansion) were considered by the Court to be the most important factor ("the ultimate regulator of competitive conduct"), and here the evidence supports them being low. There is capacity and significant presence of rivals in the market: It would not seem credible to think that any attempt by the merged entity to raise prices to supra-competitive levels would not be an opportunity for those rivals to use that capacity against it,
- (c) products of the industry are characterised by differentiation and sales promotion,
- (d) there are no vertical relationships with customers (nor are any supply arrangements long term), and

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<sup>29</sup> Decision 587, 31 August 2006.

<sup>30</sup> *Re Queensland Co-operative Milling Association* (1976) 8 ALR 481, 516

- (e) there are no formal, stable or fundamental arrangements between firms restricting their ability to operate as independent entities.

**Matthew Dunning QC**