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COMMERCE COMMISSION

Decision No. 396

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

Mainland Products Limited

and

Nelson Milk Company

The Commission: M J Belgrave (Chair)
E C A Harrison
E M Coutts

Summary of Proposed Acquisition: The acquisition by Mainland Products Limited, or any of its interconnected bodies corporate, of up to 100% of the shares in or assets of Nelson Milk Company Limited

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

Date of Determination: 7 June 2000

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CONTAINED IN SQUARE BRACKETS []**

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THE PROPOSAL

- 1 On 23 May 2000, the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 (“the Act”), seeking clearance for the acquisition by Mainland Products Limited (“Mainland”), or any of its interconnected bodies corporate, of up to 100% of the shares in or assets of Nelson Milk Company Limited (“Nelson Milk”).

THE PROCEDURES

- 2 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. Accordingly, a decision on the Application is required by 7 June 2000.
- 3 Mainland sought confidentiality for certain information contained in the Application, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission’s determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.
- 4 The Commission’s determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission.
- 5 In the course of their investigation of the proposed acquisition, Commission staff have discussed the Application with a number of parties. These parties included New Zealand Dairy Foods Limited (“Dairy Foods”), Southern Fresh Milk Co Limited (“Southern Fresh”), supermarket groups including Woolworths (NZ) Ltd, Progressive Enterprises Limited, Foodstuffs (South Island) Ltd, the South Island Milk Vendors Federation, and the major oil companies.

THE PARTIES

Mainland Products Limited (“Mainland”)

- 6 Mainland is a private company owned 83% by Kiwi Co-operative Dairies Limited (“Kiwi”) and 17% by Aorangi Laboratories Ltd. Kiwi is the second largest dairy co-operative in New Zealand, and Aorangi Laboratories has no other involvement in the dairy industry.
- 7 Mainland’s business activities include the acquisition of unprocessed milk from Kiwi for manufacture into fresh and UHT milk, cream, yoghurt, other cultured milk products and specialty cheeses; the packing, wholesaling and marketing of certain dairy products for the domestic market; the manufacture and packaging of specialty cheeses for export; the wholesaling of processed meats and small goods; and the supply of chilled food products.
- 8 The major brands of dairy products owned and used by Mainland are Mainland, Valumetric, Galaxy, Ferndale, Tararua and Meadow Fresh. Of particular relevance to this Application is Mainland’s involvement in the processing and wholesale supply of town milk in the South Island and the supply of its Meadow Fresh milk brand.

- 9 Mainland supplies the majority of the South Island from Christchurch, and supplies town milk throughout the Southland and Otago regions from a base in Dunedin.

Nelson Milk Company Ltd (“Nelson Milk”)

- 10 Nelson Milk is a town milk processor, owned by 17 suppliers and shareholders. It has a franchise agreement with Dairy Foods for use of the Anchor brand in the Marlborough, Nelson and West Coast regions. Nelson Milk also processes and supplies milk under its own brand Sun City.
- 11 Nelson Milk distributes town milk in Nelson, down the West Coast, and in Blenheim and Marlborough. Nelson Milk also supplies housebrand milk to the Big Fresh supermarket in Nelson.

OTHER RELEVANT PARTIES

New Zealand Dairy Foods Limited (“Dairy Foods”)

- 12 Dairy Foods is a subsidiary of New Zealand Dairy Group (“Dairy Group”). Dairy Group is the largest dairy co-operative in New Zealand. Dairy Foods is a public unlisted company with Dairy Group holding 50 percent of the shares of the company, and around 7,000 Dairy Group farmer shareholders holding the balance of shares. It is noted that in June 1999, Dairy Group acquired South Island Dairy Co-operative Limited (“SIDCO”).
- 13 Dairy Foods manufactures, markets and distributes chilled dairy products in the domestic and export markets. Dairy Foods, through three subsidiaries, is organised into three separate business units. Of relevance to this Application is the role of the New Zealand Milk Corporation Limited, Dairy Foods’ wholly owned subsidiary. It processes milk, cream, flavoured milk, juice drinks and some specialty products for local consumption. Dairy Foods does not currently process town milk in the South Island, although it has franchise arrangements with both Nelson Milk and Southern Fresh to process milk under the Anchor brand for distribution throughout the South Island. Dairy Foods distributes town milk in the Canterbury region that is processed by Southern Fresh.

Southern Fresh Milk Company Limited (“Southern Fresh”)

- 14 Southern Fresh, based in Invercargill, is involved in the processing and supply of town milk under both the Anchor brand and the company’s own brand, So Fresh. Southern Fresh supplies town milk from Invercargill to North Canterbury, and holds the Anchor franchise for Southland and Otago.

Supermarkets, Oil Companies and Milk Vendors

- 15 Forty percent of town milk in New Zealand is sold through supermarkets. The three supermarket chains in New Zealand are the Foodstuffs companies, Progressive Enterprises Limited and Woolworths (NZ) Limited. Supermarkets sell both the milk companies’ brands, and their own brands (“housebrands”). The oil companies are also significant retailers of milk through their service station outlets. Milk vendors

also account for significant retail sales, delivering milk to the route trade, and through home delivery, which is still common in the South Island.

BACKGROUND INFORMATION

Industry Background

- 16 The Commission has assessed a number of business acquisition proposals involving dairy companies recently. These include:
- *MergeCo* Draft Determination, 27 August 1999 (“*MergeCo*”).
 - *Kiwi Co-operative Dairies Limited/South Island Dairy Co-operative Limited (SIDCO)* Decision 341, 26 February 1999.
 - *Mainland Products Limited/South Island Dairy Farmers Co-operative Limited (SIDF)* Decision 324, 12 May 1998.
- 17 These reports, particularly *MergeCo* provide detailed background to the dairy industry. There have been no material changes to the industry since *MergeCo*.¹ It is not therefore intended to provide a detailed description of the industry in this report.

MARKET DEFINITION

Introduction

- 18 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be assessed in terms of section 47(1) of the Act.
- 19 Section 3(1A) of the Act provides that:
- “...the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.”
- 20 Principles of market definition are contained in *Telecom Corporation of New Zealand Ltd v Commerce Commission*², and in the Commission’s *Business Acquisition Guidelines*.³ These principles are outlined below.
- 21 Markets are defined in relation to three dimensions: product type, geographical extent and functional level. (In some situations it is also necessary to allow for time, and to consider a temporal dimension.) A market includes products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or geographical regions, when there is an incentive to do so because of a change in relative prices. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. Within this space, a hypothetical, profit-maximising, monopoly

¹ It is noted that Kiwi Co-operative Dairies Limited purchased Northland Co-operative Dairy Company Limited in February 2000.

² (1991) 4 TCLR 473

³ Commerce Commission, *Business Acquisition Guidelines*, 1999, pp 11-16

supplier could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

- 22 A properly defined market includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" (the "*ssnip*" test), assuming that other terms of sale remain unchanged.
- 23 Markets are also defined by functional level. Typically, the production, distribution and sale of products occur through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next. For example, that between manufacturers and wholesalers might be called the "manufacturing market", while that between wholesalers and retailers is usually known as the "wholesaling market".
- 24 The above discussion focuses on 'demand-side' factors in line with the Commission's general approach to market definition. 'Supply-side' factors are not generally considered by the Commission in its preliminary analysis of market definition, but are considered as part of the competition analysis that identifies market participants and the potential constraint from market entry.

The Relevant Markets

- 25 For the purposes of considering the market aggregation that would result from the proposed acquisition, the Applicant submits that the relevant markets are those for the acquisition/supply of unprocessed milk and the processing and wholesale supply of town milk in the South Island.
- 26 In previous decisions relating to the dairy industry the Commission has discussed, in some detail, the product, geographic and functional levels associated with these markets. It is not proposed to repeat all of that detailed information in this report.

Market for the Acquisition/Supply of Unprocessed Milk in the South Island

- 27 In recent decisions the Commission has concluded that there is a market for the acquisition/supply of unprocessed milk in the South Island. It continues to hold this view.
- 28 The Applicant submits that the proposed acquisition will have no effect on competition in this market. The Applicant states that the quantity of unprocessed milk purchased by Mainland from Kiwi, and the quantity of unprocessed milk purchased by Nelson Milk from its farmers, represents a tiny percentage of the total quantity of unprocessed milk sold in the South Island. As such, there will be minimal aggregation resulting from the proposed acquisition.
- 29 The effect of this proposal will be that the 17 farmers currently supplying milk to their own company, Nelson Milk, will now continue to supply this milk although the new owner will be Mainland.

- 30 The Commission is satisfied that there will be little change in the market for the acquisition/supply of unprocessed milk in the South Island as a result of the acquisition. Consequently, it is not proposed to analyse this market in any further detail.

Market for the Processing and Wholesale Supply of Town Milk in the South Island

- 31 Pasteurised fresh milk sold in New Zealand is referred to as “town milk”. Town milk now generally includes a variety of milk types, flavoured fresh milks and cream. Milk types include the traditional full cream and homogenised varieties, and more recently introduced products such as reduced fat and calcium enriched milks.
- 32 Town milk is processed and distributed by a number of dedicated town milk companies, most of which are co-operatives, and by the domestic operations of the largest dairy co-operatives, namely Dairy Foods (Dairy Group) and Mainland (Kiwi). Dairy Foods and Mainland have extensive retail distribution networks, as well as providing home delivery through franchised operators.
- 33 The Applicant notes that, in the past, unprocessed milk for town milk processing was supplied to specialist town milk companies by farmers dedicated to town milk supply. Those farmers received premiums for the more expensive milk produced during the winter months. Following the deregulation of the town milk industry in 1993, the major dairy co-operatives took over and rationalised a number of the town milk suppliers, integrating their operations within the co-operatives’ wider manufacturing activities. Unprocessed milk for town milk is then taken from the seasonal milk flow supplied to the manufacturing co-operatives, with a significant premium being offered to sufficient suppliers to provide milk over the winter period.
- 34 The relevant product market is that for town milk. Studies both in New Zealand and overseas indicate that the price elasticity of demand for town milk is very low, generally less than -0.2%,⁴ which strongly suggests that there are no close substitutes for town milk. Further, anecdotal evidence suggests that price increases in recent times have had little or no appreciable effect on demand.
- 35 The relevant functional market is for the processing and wholesale supply of town milk.
- 36 The Commission has, on a number of previous occasions, defined the geographic extent of the market for the processing and wholesale supply of town milk as being island-wide, with separate North and South Island markets.⁵
- 37 In *MergeCo*, in relation to the demand side of the market, the Commission noted that there is a trend towards national distribution and marketing of specific milk brands. Also, that the large retail customers of the town milk companies, in particular supermarkets and oil companies, prefer to deal with a small number of suppliers for administrative simplicity, and are encouraging a trend towards national supply contracts.

4 See, for example, R J Brodie, R G Moffitt and J D Gough, “The Demand for Milk: An Econometric Analysis of the New Zealand Market”, Research Report No 147, Agricultural Economics Research Unit, Lincoln University, January 1984.

⁵ Refer Decision 324 and the *MergeCo* Draft Determination.

38 However, on the supply side, the market is still divided into North Island and South Island operations. In the North Island, Mainland supplies town milk from Kaitaia to Wellington from Whangarei and Palmerston North. Dairy Foods supplies town milk from Auckland to Wellington from Takanini (South Auckland). In the South Island, Mainland supplies the majority of the South Island from Christchurch. Southland and Otago are supplied from a base in Dunedin. Dairy Foods has a more limited presence in the South Island. Dairy Foods has recently established a sales and distribution operation in Christchurch, and has Anchor franchises operated by Nelson Milk and Southern Fresh. [

].

39 Town milk is not currently transported across Cook Strait. As stated in previous decisions, town milk processors view inter-island transport as technically possible but inferior to production and distribution in each island. As such, town milk that is sold in the South Island is processed in the South Island. The Applicant notes that there have been a number of exceptions to this rule. For example, Mainland has, in the past, transported small quantities of winter milk from the South Island to the North Island.

40 It has been previously suggested that the adoption of ‘extra shelf life’ (ESL) technologies could result in the inter-island transportation of town milk. [

].

41 The smaller town milk companies have tended to operate in more regionally defined areas. The main reason for the limited reach of the smaller companies is the cost and difficulty of establishing a large distribution network and a national brand. For example, Southern Fresh is currently supplying town milk to Christchurch, Otago and Southland only [

].

42 Having regard to the above, the Commission considers it accurate to continue to define a South Island market for the processing and wholesale supply of town milk.

Conclusion on Market Definition

43 The Commission concludes that, for the purposes of analysing the current proposal, the relevant market is that for the processing and wholesale supply of town milk in the South Island (“the South Island town milk market”).

COMPETITION ANALYSIS

Introduction

44 The competition analysis assesses competition in the relevant markets to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of dominance.

45 Competition in a market is a broad concept. It is defined in section 3(1) of the Commerce Act as meaning “workable or effective competition”. In referring to this definition the Court of Appeal said:⁶

“That encompasses a market framework which participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency.”

The Dominance Test

46 Section 47(1) of the Act prohibits certain business acquisitions. It provides that:

“No person shall acquire assets of a business or shares if, as a result of the acquisition, -

- (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
- (b) That person’s or another person’s dominant position in a market would be, or would be likely to be, strengthened.”

47 Section 3(9) of the Act states:

“For the purposes of sections 47 and 48 of this Act, a person has, or 2 or more persons that are interconnected or associated together have, as the case may be, a dominant position in a market if that person as a supplier or an acquirer, or those persons as suppliers or acquirers, of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market...”

48 Section 3(9) also states that a determination of dominance shall have regard to:

- (a) “The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
- (b) The extent to which that person is, or those persons are, constrained by the conduct of competitors or potential competitors in that market:
- (c) The extent to which that person is, or those persons are constrained by the conduct of suppliers or acquirers of goods or services in that market.”

49 The test for dominance has been considered by the High Court. McGechan J stated:⁷

“The test for ‘dominance’ is not a matter of prevailing economic theory, to be identified outside the statute.”

“Dominance includes a qualitative assessment of market power. It involves more than ‘high’ market power; more than mere ability to behave ‘largely’ independently of competitors; and more than power to effect ‘appreciable’ changes in terms of trading. It involves a high degree of market control.”

This test was approved by the Court of Appeal.⁸

⁶ *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 564-565

⁷ *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)

50 The Commission has acknowledged this test in its *Business Acquisition Guidelines*, where it is stated:

“A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction.”⁹

The Commission’s *Business Acquisitions Guidelines* further state:

“A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability.”¹⁰

51 The Commission’s role in respect of an application for clearance of a business acquisition is prescribed by the Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined. This test is applied in the following analysis.

The Market for the Processing and Wholesale Supply of Town Milk in the South Island

Market Concentration

52 An examination of concentration in a market often provides a useful first indication of whether a merged firm may be constrained by other participants, and so the extent to which it may be able to exercise market power.

53 In the Commission’s view, as expressed in its *Business Acquisitions Guidelines* (at page 17), a dominant position in a market is generally unlikely to be created or strengthened, where, after the proposed acquisition, either of the following situations exist:

- the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market; or
- the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market, and faces competition from at least one other market participant having no less than in the order of a 15% market share.

54 These “safe harbours” recognise the importance of both absolute levels of market share, and the distribution of market shares between the merged firm and its competitors, in determining the extent to which the rivals are able to constrain the behaviour of the merged firm.

55 If a proposed acquisition falls within these safe harbours, the Commission will usually grant approval. If the acquisition falls outside them, the Commission will consider a range of additional factors before drawing conclusions on market dominance.

⁸ *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)

⁹ *Business Acquisition Guidelines 1999*, Section 7, p 21

¹⁰ *Business Acquisition Guidelines 1999*, Section 7, p 21

- 56 Market share information has been provided by the Applicant, Dairy Foods and other interested parties to this application. On the basis of this information, the Commission has formulated estimated market shares. These estimates are set out below in Table 1.

TABLE 1

**Estimated Shares of Town Milk Sales in the South Island
(Litres)**

Market Participants	Market Shares
Mainland	[]%
Nelson Milk	[]% ¹¹
Marlborough Milk	[]% ¹²
Dairy Foods	[]%
Southern Fresh	[]% ¹³
	100%

- 57 The Applicant has suggested that:
- the Nelson region represents about []% of the South Island town milk market;
 - Nelson Milk supply approximately []%¹⁴ of the Nelson region equating to []% of the South Island town milk market;
 - of Nelson Milk's []% share of the South Island town milk market, []% is represented by Anchor Milk, with the remainder ([]%) being represented by Nelson Milk's own brand, Sun City; and
 - Mainland will acquire all of the market share currently held by Sun City and some of the market share currently held by Anchor in the Nelson region estimated to equate to a total gain in market share of []% in the South Island town milk market.
- 58 In assessing the merged firm's likely market share the Commission notes that:
- Mainland currently has a []% share of the South Island town milk market;
 - Marlborough Milk (with []% market share of the South Island town milk market) currently produces Meadow Fresh milk under a franchise agreement with Mainland; and
 - any gain in market share to Mainland resulting from the proposed acquisition of Nelson Milk is likely to be relatively small in relation to the South Island town milk market and difficult to accurately forecast, being dependant upon the success of Dairy Foods' entry into the market and its efforts to protect its market share in the Nelson region.
- 59 The Commission concludes that Mainland would increase its share of the South Island town milk market as a result of its proposed acquisition of Nelson Milk. Although the

¹¹ The Applicant has suggested []% of the milk sold by Nelson milk is Anchor milk. Dairy Foods have suggested this figure is closer to []%.

¹² []% of the milk produced by Marlborough Milk is Meadow Fresh brand.

¹³ Southern Fresh advise that approximately []% of the milk they sell is Anchor milk.

¹⁴ Dairy Foods have advised that Nelson Milk's market share in the Nelson Region is closer to []%

exact quantification of the gain in market share is difficult to predict, the merged firm's market share would clearly fall outside the Commission's safe harbours.

- 60 As referred to above, market share alone is not sufficient to establish a dominant position in a market (see para 55). Accordingly, the Commission considers a range of additional factors before drawing conclusions on market dominance. These additional factors are discussed below.

Constraint from Existing Competition

- 61 The Commission has previously considered the level of competition in the South Island town milk market in the *Mainland/SIDF* decision. In that decision the Commission concluded that the existing competition would not have been a sufficient constraint on Mainland/SIDF to alleviate dominance concerns. The Applicant has expressed its agreement with the Commission's conclusion in that decision, having regard to the profile of the South Island market at that time.
- 62 The Applicant has submitted that the state of the market has changed since the *Mainland/SIDF* decision in 1998, because Dairy Foods has acquired the distribution and marketing of Anchor milk in the Canterbury region.
- 63 At the time of the *Mainland/SIDF* decision Anchor Milk sold in the South Island was processed, packaged and distributed by Nelson Milk and Southern Fresh under franchise arrangements with Dairy Foods. The franchise arrangement with Southern Fresh has now altered, with Dairy Foods taking over the distribution of Anchor milk in the Canterbury region, although this milk is still processed and packaged by Southern Fresh.
- 64 Dairy Foods has confirmed to the Commission that it has taken over the distribution of Anchor milk in Canterbury. This lends support to the view that Dairy Foods' intends to expand its operations in the South Island. This point is discussed more fully below (see paras 70 to 95).
- 65 The Commission notes that Dairy Foods' current operations in the South Island is confined to distribution and marketing in the Canterbury region. Dairy Foods does not yet have its own town milk processing plant in the South Island. Consequently Dairy Foods current presence as a relatively minor player has had little or no impact on the level of existing competition in the South Island town milk market.
- 66 Mr Andrews, General Manager of Dairy Foods, advised the Commission that Dairy Foods is likely, as a result of the proposal, to lose market share in the short term in the Nelson region. [

].

- 67 [

].

- 68 The Commission considers that Southern Fresh, with its present level of market share, location and scope of its distribution network, is unlikely to provide a sufficient constraint on the merged firm to prevent it from exercising market power in the South Island town milk market.
- 69 The Commission concludes that the existing competition is unlikely to provide sufficient constraint on the merged firm to remove dominance concerns.

Constraints from Market Entry

- 70 In the Commission's view, a business acquisition is unlikely to result in a dominant position in a market if the threat of new entrants acts as a significant constraint on behaviour in that market. An assessment of the nature and extent of that constraint represents a key element of the Commission's assessment of competition and market dominance. Evaluation of the weight to be given to the possibility of new entry requires assessing the conditions of entry, and identifying any barriers to entry. If these barriers are high in aggregate, the likelihood of new entry is diminished.
- 71 The Commission has previously looked at the conditions and barriers to entry into this market in *MergeCo*. In *MergeCo* the Commission observed that the major barriers to entry relate to the need for a distribution network and the critical mass required to make entry economic. The Commission stated:
- “The major economic issue is the need for a distribution network and the critical mass required to make entry economic. To be able to gain significant market share requires the ability to supply major retail chains seven days a week, sometimes several times a day. For supermarkets, it can be necessary to ‘merchandise’, that is deliver to, organise and maintain stock in the shop chiller. While some supermarkets do have regional arrangements, there is a strong preference for companies that can supply most if not all stores – island wide or nationwide if possible.”¹⁵
- 72 In *MergeCo* the Commission concluded that the importance of distribution is one of the prime reasons why:
- Mainland and Dairy Foods have such a strong position in terms of national town milk sales, and
 - small companies, while important in some areas, lack the critical mass to supply large customers, and are therefore unable to compete directly with Dairy Foods and Mainland.¹⁶
- 73 Currently Dairy Foods' market share in the South Island is relatively small. All Dairy Foods' milk distributed in the South Island is processed and packaged by Southern Fresh and Nelson Milk under franchise arrangements.
- 74 The Commission has previously discussed the possible entry by Dairy Foods into the South Island market in *MergeCo* where it noted:
- “there is little doubt that for an operation of Dairy Foods' size establishing a plant is not a major barrier nor is establishing a distribution network.”¹⁷

¹⁵ *MergeCo* Draft Determination, 27 August 1999, paragraph 339

¹⁶ *MergeCo* Draft Determination, 27 August 1999, paragraphs 340, 342

¹⁷ *MergeCo* Draft Determination, 27 August 1999, paragraph 352

75 Dairy Foods now has access to a substantial supply of milk in the Canterbury region as a result of Dairy Group¹⁸ acquiring SIDCO. []].

76 In assessing the constraint from market entry, the Commission's approach is to consider whether the entry of new participants in response to the exercise of market power is likely, sufficient in extent, timely and sustainable. This is referred to as the "lets" test.

77 []

Likelihood and Sustainability of Entry

78 The theoretical possibility of entry is an insufficient constraint on the exercise of market power to alleviate concerns about market dominance. In order to constrain market participants, entry must be likely and sustainable in commercial terms. In the Commission's view, an economically rational business will be unlikely to enter a market unless it has a reasonable prospect of achieving a lasting and satisfactory return on its investment.¹⁹

79 Dairy Foods is a substantial national operation and is the predominant manufacturer and wholesale supplier in a number of domestic food and beverage categories including: yoghurt, dairy foods, desserts, custards, butter, milk and cream and flavoured milk.²⁰

80 At the time of the *MergeCo* draft determination Dairy Foods' and Mainland's respective estimated market shares of national town milk sales were []% and []%. Dairy Foods' market share, while being relatively strong in the North Island with a []% market share, is relatively small at present in the South Island, as shown in Table 1.

81 Mr McClure, Chief Executive of Dairy Foods, has advised the Commission that there are several reasons why Dairy Foods now wishes to establish its own processing plant in the South Island. These reasons include Dairy Foods desire to:

- []
- a need²¹ to bring Dairy Foods' []²² []

¹⁸ Dairy Group owns 50% of Dairy Foods and []].

¹⁹ *Business Acquisition Guidelines 1999*, Sections 5.1 and 5.4, p 19-20

²⁰ *MergeCo* Draft Determination, 27 August 1999, paragraph 37

²¹ This need is derived from pressure for supermarkets and oil companies wanting to deal with Dairy Foods on a national basis.

²² Country Foods New Zealand Ltd: which produces butter, cheese, yoghurts, desserts, dairy foods, cottage and cream cheese for supply to the local market.

82 Mr McClure advised the Commission that []

83 []

84 []

85 []

Extent of Entry

86 The threat of market entry must be at a level that is likely to cause market participants to react in a significant manner if it is to constrain market participants. The Commission does not consider entry which might occur only at relatively low volumes or in localised areas, to represent a sufficient constraint to alleviate concerns about market dominance.²³

87 []

Timeliness of Entry

88 To effectively constrain the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers or users in the relevant market are detrimentally affected to a significant extent.

89 As a guide, the Commission considers that, for most markets, entry which cannot be achieved within two years from initial planning is unlikely to satisfy the timeliness requirement of the *lets* test. The Commission has noted, however, that the relevant time period has to be considered on a case-by-case basis.²⁴

²³ *Business Acquisition Guidelines 1999*, Section 5.2, p 19-20

²⁴ *Business Acquisition Guidelines 1999*, Section 5.3, p 20

90 []].

91 **Processing Plant:** As noted above,²⁵ []

92 **Supply of Milk:** []:
[]

93 **Franchise Arrangements:** []].

Conclusion on *lets* test

94 The Commission is satisfied that Dairy Foods' []:
• is likely and sustainable in the context of the size of Dairy Foods' operation and its market share of national town milk sales;
• will be of a sufficient extent; and
• will be timely in that it is likely that Dairy Foods' []].

95 The Commission concludes that the *lets* test is satisfied.

Countervailing Power of Supermarkets, Oil Companies and Milk Vendors

96 The supermarket chains, oil companies, and milk vendor groups are the major acquirers of town milk in New Zealand. The Applicant has suggested that supermarkets account for approximately 40% of total town milk retail sales with 46% of supermarket milk sales being housebrands. Milk vendors service the other 60% of the market, 40% being food service/route trade and 20% home delivery. Of the route

²⁵ See Likelihood and Sustainability of Entry at paragraphs 82 to 84

trade, 25% are oil companies. The Commission has confirmed these figures to be approximately accurate with the supermarket chains and South Island milk vendors.

- 97 The Applicant has suggested that the three supermarket chains (Foodstuffs companies, Progressive Enterprises Ltd and Woolworths (NZ) Limited) have a high degree of countervailing power in the market. Consequently they are able to constrain Dairy Foods or Mainland if they attempt to increase prices or reduce quality.
- 98 The Commission has been advised that the supermarket chains do not consider that the proposed acquisition will have a significant effect on the range of supply options available to them. All three chains feel they had the ability to switch between processors for the supply of their housebrands. However, the supermarkets feel that, in the absence of an increased presence by Dairy Foods in the South Island, their ability to restrict Mainland in the use of its market power would be significantly diminished. This was a particular concern for Foodstuffs (South Island) Ltd who unlike the other two chains do not negotiate their supplies of town milk on a nation wide basis.
- 99 Mr McClure advised the Commission that Dairy Foods [].
- 100 The oil companies also have a degree of bargaining power in the market as an increasing volume of milk is being sold through service stations (at the expense of home delivery and corner dairy sales). The Commission also notes that there is a trend towards oil companies negotiating nationwide purchasing contracts with processors for the supply of town milk to service stations.
- 101 The Applicant has suggested that milk vendors also have a degree of market power and pointed to the switch by 17 of the 18 milk vendors from Nelson Milk to South Island Dairy Farmers in 1997. [].
- 102 The Commission considers that the countervailing power of supermarkets, oil companies and milk vendors in itself is unlikely to provide sufficient constraint on the merged firm to remove dominance concerns.

Conclusion on the South Island town milk market

- 103 As noted above (see para 68) the Commission considers that Southern Fresh, having regard to its present level of market share, location and scope of its distribution network, would be unable to provide a sufficient constraint on the merged firm to prevent it from exercising market power in the South Island town milk market
- 104 The Commission acknowledges that while the supermarkets, oil companies and milk vendors are able to exercise some constraint on the merged firm it is believed that this constraint is not sufficiently strong in the absence of Dairy Foods entry into the South Island town milk market to remove dominance concerns.

- 105 Although the merged firm will have a high market share in the South Island town milk market, falling outside the Commission's "safe harbours": the constraints from market entry, [
-], would be sufficient to remove dominance concerns in the market.
- 106 The Commission concludes that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the South Island town milk market.

OVERALL CONCLUSION

- 107 The Commission has considered the impact of the proposed acquisition in the following markets:
- the market for the acquisition/supply of unprocessed milk in the South Island; and
 - the market for the processing and wholesale supply of town milk in the South Island.
- 108 Having regard to the factors set out in section 3(9) of the Commerce Act 1986, and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in any market.

DETERMINATION ON NOTICE OF CLERANCE

- 109 Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Mainland Products Limited, or any of its interconnected bodies corporate, of up to 100% of the shares in or assets of Nelson Milk Company Limited.

Dated this day of June 2000

M J Belgrave
Chair