

COMMERCE COMMISSION

Decision No. 418

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

P&O COLD LOGISTICS (NZ) LIMITED

and

ESKIMO LOGISTICS GROUP LIMITED

The Commission: M J Belgrave
M N Berry
P R Rebstock

Summary of Application: The acquisition by P&O Cold Logistics (NZ) Limited of all or some of the business and assets of Eskimo Logistics Group Limited and its wholly owned subsidiary ELG Properties Limited but excluding Eskimo's Perishables Air Freight Forwarding business.

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: 16 February 2001

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THE PROPOSAL

1. On 7 December 2000, the Commerce Commission (“the Commission”) registered a notice pursuant to section 66(1) of the Commerce Act 1986 (“the Act”), in which clearance was sought by P&O Cold Logistics (NZ) Limited (“P&O”) for the acquisition of all or some of the business and assets of Eskimo Logistics Group Limited and its wholly owned subsidiary ELG Properties Limited (together, “Eskimo”) but excluding any assets of Eskimo’s Perishables Air Freight Forwarding business.

THE PROCEDURES

2. The notice was registered on 7 December 2000. 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 notice agree to a longer period. An extension was sought by the Commission. Accordingly, a decision was required by 16 February 2001.
3. In its application, P&O sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the specific information for a period of 20 working days from the Commission’s determination notice. When that 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 staff. In the course of its investigation, Commission staff discussed the application with the following parties:
 - P&O
 - Eskimo
 - Polarland/Clelands
 - Polarcold
 - McCains
 - Woolworths
 - Progressive Enterprises
 - Mainfreight
 - Kings Wharf Coldstore
 - North Port Coldstore
 - Linfox
 - Christchurch Coldstore
 - Owens Coolair
 - Temperature Controlled Distribution
 - Foodstuffs (South Island)
 - Streets/Unilever
 - Dandys Coldstore
 - Avenue Coldstore

- Whakatu Coldstores
 - Dairy Board
 - Amalgamated Food Distributors
 - Mainstream
5. The investigation has been based on the assumption that P&O will take possession of all of Eskimo's assets relating to refrigerated warehousing, but not of any assets relating to the Eskimo freight forwarding business.

THE PARTIES

P&O Cold Logistics (NZ) Ltd

6. P&O is a subsidiary of P&O New Zealand Limited and operates within the Cold Logistics Division of the Peninsula & Oriental Steam Navigation Company, a company incorporated by Royal Charter in the United Kingdom and listed on the London and Australian Stock exchanges.
7. P&O is involved in the provision of distribution and logistics services for suppliers of perishable foods. This includes the provision of refrigerated warehousing. It states in its application that it specialises in the provision of "order picking" for food retailers and manufacturers. P&O is represented in Auckland, Christchurch, and Palmerston North. The location of P&O's refrigerated warehouses is shown in appendix A, along with their capacities (in pallet spaces).
8. P&O entered the New Zealand market in 1987. Since entering, it has grown at a reasonably quick rate and is now one of the biggest players in the industry. In 1992, its turnover was [], while in 2000 its turnover was [].

Eskimo

9. Eskimo is also involved in the provision of distribution and logistics services to suppliers of perishable goods. This includes the provision of refrigerated warehouses and ancillary services. Eskimo has generally focused its business on primary producers and wholesalers (essentially for meat, fish, dairy and horticultural products), although in recent years it has acquired some retail and manufactured goods contracts.
10. The application states that Eskimo is one of New Zealand's largest perishable products logistics groups, operating distribution facilities in Canterbury, Auckland, Tauranga, and the Port of Bluff in Southland. The location of Eskimo's facilities is shown in Appendix A along with their respective capacities (in pallet spaces). With the exception of part of its Auckland facility, Eskimo's distribution facilities are leased.
11. Eskimo was established by the Greenstone Fund, an investment company, as a venture capital project in 1994. The goal was to quickly build the company and then either sell it or float it on the stock market. Many industry participants view Eskimo as a maverick in the industry. Since entering the market, it has aggressively acquired market share and now has turnover of around [].

Other Parties

Polarcold

12. Polarcold is a Timaru based company, established in 1956, which mainly provides bulk storage facilities for primary and dairy products. Its main storage area is in Timaru. However, it also has significant presence in Dunedin, Christchurch and Whakatapu. Up until a few months ago it was involved in a joint venture in Auckland with an Australian firm, Cleland. The joint venture was called Polarland.
13. Polarcold's locations are indicated in Appendix A.

Clelands/Polarland

14. Clelands is a long established Australian logistics firm. It is a significant player in the Australian cold logistics industry. Clelands entered the New Zealand market through the joint venture (mentioned above) with Polarcold in 1995, called Polarland. Recently, it bought out Polarcold's share of the joint venture.

BACKGROUND

15. The firms involved in the proposed acquisition operate refrigerated warehouses. Within the industry, the use of the warehouses can be separated into two main areas. These are:
 - Bulk Storage
 - Order-picking for Manufacturers/Retailers (also known as "contract warehousing")

These activities are described below.

Bulk Storage

16. Suppliers of bulk storage mainly provide services to producers of primary goods such as meat, fish, or fresh vegetables. Producers of such goods will often have their own stores for their goods. However, they will still use independent warehouses to store the "overflow" of goods during heavy production periods. Other producers choose to outsource the storage altogether.
17. Providers of cold storage in this area of the industry often locate their coldstores close to ports. This is because around 95% of produce from the meat and dairy industries are exported so a warehouse close to a port is convenient. It allows them to keep a constant flow of goods to the ships, and helps lower stevedoring expenses.
18. Providers of bulk storage often also provide blast-freezing facilities, especially if the facility stores meat for export.

Order-picking for Manufacturers/Retailers

19. For manufacturers of perishable finished goods, refrigerated warehouses act as a distribution centre. Distribution in this sense has been under-going change in the last few years. Many manufacturers have been shifting to "centralised distribution" in line with overseas trends. In the past, manufacturers would organise for their goods to be delivered to retailers straight from the factory. Centralised warehousing occurs where manufacturers send their goods to an intermediary warehouse prior to being sent to the

retailer. The warehouse will then pick out the goods to order (“order-pick”) and arrange delivery to the retailer.

20. Centralised warehousing offers several advantages. It allows manufacturers and retailers the opportunity to concentrate on their key competencies. The responsibility for accurate orders can be placed on the warehouse, which faces the threat of losing the contract in the event of mistakes. A further advantage is that centralised warehousing offers savings in distribution costs.
21. Although there has been a shift to centralised warehousing by manufacturers, the shift is understood to be very gradual. [] has suggested that this is simply because New Zealand manufacturers are not aware of their distribution costs and hence are not aware of potential savings that could be gained through centralised distribution. In addition, some manufacturers have been reluctant to outsource simply because they believe that doing their own distribution improves quality control.
22. Centralised warehousing has offered significant efficiency gains for retailers (principally supermarkets). With centralised warehousing the various lines are stored in one warehouse. The supermarket will place orders with the warehouse for its stock requirements between three and five times a week. The warehouse will order pick the required goods and arrange delivery to the supermarkets. The order picking simply involves driving a pallet around the warehouse and loading on the required goods.
23. One advantage to supermarkets of centralised warehousing is that it greatly reduces the number of trucks visiting the supermarket (and the number of trips generally (see Appendix B)). Prior to centralised warehousing numerous trucks delivered goods to the supermarkets. For this reason, supermarkets have been pressuring manufacturers to switch to centralised warehousing.
24. Three supermarket chains currently outsource their order picking. These are Progressive Enterprises, Woolworths, and Foodstuffs (Auckland). The firms that do the order-picking for these chains are Eskimo, P&O, and Polarland, respectively. Foodstuffs (Wellington) and Foodstuffs (South Island) both do their own warehousing.
25. The nature of order-picking is that goods are quickly turned over. For example, Polarland estimates that, on average, it turns over goods three times per week. By contrast goods might be stored in bulk storage facilities for up to 9 months. Industry participants have suggested this means order-picking requires significantly different competencies.

Relevant Legislation

26. There is only one area of the market that is affected by legislation to a significant degree. That is for those firms storing meat prior to export, as this produce is subject to MAF regulations. Compliance with these regulations is understood to be quite onerous on firms, requiring such things as the regular testing of water supply and individual labelling for each carton of meat. Firms that have MAF accreditation generally have a person working full-time to ensure the various aspects of complying with the regulations are met.

MARKET DEFINITION

Introduction

27. The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of

the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.

28. 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.”

29. Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,¹ *Commerce Commission v Carter Holt Harvey Building Products Limited*,² and in the Commission’s *Business Acquisition Guidelines* (“the Guidelines”).³ A brief outline of the principles follow.

30. Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses 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 across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

31. 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.

32. Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the application has to be determined as part of the market definition. 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”.

Product/Function market

33. The applicants have submitted that the markets affected are:

“For the provision of commercial refrigerated warehouse and distribution services for primary industry customers and for consumer food industry customers.”

¹ (1991) 4 TCLR 473.

² Williams J, 18 April 2000, HC, yet to be reported.

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

34. Market enquiries have suggested that provision of bulk storage and order-picking are two different services. As mentioned above bulk storage is where goods are stored for longer periods, generally to cover the overflow of goods. These goods are usually destined for export. Order-picking performs a domestic distribution role. Thus, from a demand-side point of view they are not substitutable.
35. Notwithstanding the absence of demand-side substitution, consideration has been given to whether all refrigerated warehousing providers are in the same market by virtue of a supply-side approach to market definition. If a firm that specialises in (say) bulk storage could quickly, and at low cost, switch to order-picking, and vice versa, then providers of bulk storage and order-picking services may be in the same market.
36. The Commission has heard conflicting submissions regarding the extent to which switching may occur. [] was of the view that firms can and do switch between order-picking and bulk storage. It noted that many warehouses are segmented so firms can have areas at different temperatures and these areas may be used for different purposes. There would appear to be many firms in the market who provide both order-picking and bulk storage services at the same facility.
37. [], however, did not believe switching was quite so straight-forward. It was of the view that order-picking requires a completely different management technique. As the industry requires “just-in-time” delivery the competencies required are strong logistical skills which ensure timely and reliable delivery. In addition, costings and routines are different due to the requirements of the high turnover of stock. [] shared similar views. It was of the view that concentrating on one or the other was the most effective way of approaching the market.
38. Retail order-picking for supermarkets arguably justifies its own market, because it requires a significantly higher level of inventory and logistical control than basic manufacturer order-picking. For manufacturing order-picking a pallet of the product is broken down and distributed. With retail order-picking potentially hundreds of product lines must be broken down and sorted into combinations for distribution to supermarkets.
39. There are only three independent firms who provide retail order-picking services (Polarland, P&O, and Eskimo). However, it is unclear whether this is because of the “extreme complexity” of the task or simply because there are only three retail contracts currently available. P&O has been providing retail order-picking services for around 12 years with Woolworths; Polarland, which order-picks for Foodstuffs (Auckland), is owned by Clelands, which is a well-established Australian firm. However, Eskimo has only been in retail order-picking for a couple of years having come from a bulk storage background.
40. The Commission acknowledges that it is arguable that a supply-side approach to market definition is possible in this case. However, the Commission defines markets in a way that best assists in the competition analysis. The Commission will often define markets narrowly to assess if there are competition concerns. If there are none in relation to narrowly defined markets, then it is unlikely that problems will appear if the market is more broadly defined. Further, even if markets are defined from a demand-side point of view, supply-side substitutability is still taken account of in the competition analysis. On this basis, the Commission has determined that the markets defined are those for:
 - The provision of refrigerated warehousing and order-picking services for retail customers;

- The provision of refrigerated warehousing and order-picking services for manufacturing customers; and,
 - The provision of refrigerated warehousing services for bulk storage.
41. P&O has advised that it specialises in order-picking for manufacturers and retailers, and has no bulk storage. Therefore, there will be no aggregation in the bulk storage market. For this reason, the bulk storage market will receive no further consideration.

Geographic Market

Retail Order-picking

42. In terms of flows of goods the following is noted (as illustrated in Appendix C):
- Eskimo distributes products for Progressive throughout the North Island from its site in Auckland, and distributes throughout the South Island from Christchurch.
 - P&O distributes products for Woolworths throughout the North Island, from two sites, one in Auckland and one in Palmerston North, and throughout the South Island from Christchurch.
 - Polarland distributes goods for Foodstuffs (Auckland) for the top half of the North Island from Auckland
 - Foodstuffs (Wellington) distributes to the lower North Island, and Foodstuffs (South Island) to South Island from Christchurch.
43. Geographic markets for retail contracts (that is, for the various supermarkets) can be segmented into North and South Islands. It is noted that Eskimo services all North Island Progressive stores from Auckland, and all South Island stores from Christchurch. []].
44. []].
45. []].
46. It would therefore appear that it is economic to distribute throughout the North Island from one warehouse. Having warehouses in other areas is more likely to be an issue of reaction times.

Manufacturer Order-Picking

47. It is likely that the geographic markets for order-picking are likely to be for the North and South Island, respectively, for the same reasons mentioned above. Those manufacturers spoken to appeared to be less concerned over delivery times. For example, [] has its stock distributed throughout the North Island from Auckland, and throughout the South Island from Christchurch. It does not believe time delays are problematic because its customers were aware of the time delays and therefore make allowances for it when ordering. [] expressed similar views.

Conclusion on the markets

48. On the basis of the above analysis, the Commission considers that the relevant markets are:

- The provision of refrigerated warehousing and order-picking services for retail customers in the North Island;
- The provision of refrigerated warehousing and order-picking services for retail customers in the South Island;
- The provision of refrigerated warehousing and order-picking services for manufacturing customers in the North Island; and,
- The provision of refrigerated warehousing and order-picking services for manufacturing customers in the South Island.

COMPETITION ANALYSIS

Introduction

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

50. 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:⁴

“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.”

51. Section 3(9) of the Commerce Act states:

“For the purposes of sections 47 and 48 of this Act, a person has ... a dominant position in a market if that person as a supplier ... 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 that market and for the purposes of determining whether a person is ... in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-

- (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 ... constrained by the conduct of competitors or potential competitors in that market;
- (c) The extent to which that person is ... constrained by the conduct of suppliers or acquirers of goods or services in that market.”

The Dominance Test

52. Section 47(1) of the Commerce Act prohibits certain business acquisitions:

- “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

⁴ *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 564-565

- (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."
53. The test for dominance has been considered by the High Court. McGechan J stated:⁵
- "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*."
54. Both McGechan J and the Court of Appeal, which approved this test,⁶ stated that a lower standard than "a high degree of market control" was unacceptable.⁷ The Commission has acknowledged this test:⁸
- "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."
55. The Commission's *Business Acquisitions Guidelines* state:
- "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."
- ...
- "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 term 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." (p21)
56. The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce 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.
57. The Commission applies the dominance test in the following competition analysis.
- Market Concentration*
58. An examination of concentration in a market provides an indication of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.
59. The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act -
- "In the Commission's view, 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:

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

⁶ *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)

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

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

⁸ *Business Acquisition Guidelines*, Section 7

the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;

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.” (p 17)

60. These safe harbours recognise that both absolute levels of market share and the distribution of market shares between the merged firm and its rivals is relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state that:

“Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of shares, fall within these safe harbours.”

61. Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through market entry, also typically need to be considered and assessed.

The Market for the Provision of Refrigerated warehousing and Order-Picking Services for Retail Customers in the North Island

Market concentration

62. The Commission has assessed market share on the basis of pallet space used for the retail order-pick contracts. These are set out in Table 1 below:

**Table 1:
Estimated Market Shares for the North Island**

Firm	Capacity Used (Pallets)	Market Share (%)
P&O	[]	[]
Eskimo	[]	[]
Sub-Total	[]	[]
Polarland	[]	[]
Foodstuffs (Wellington)	[]	[]
Total	[]	100.0

Current Competitors

63. In the North Island, the merged entity’s main competitor for order-picking is Polarland. Polarland is owned by Clelands, which is a relatively large Australian firm. It has been in the Australian industry for a significant length of time and has a great deal of expertise and experience in the industry.

64. Polarland currently does order-picking for Foodstuffs (Auckland). This involves the distribution of its chilled goods from its Auckland premises to areas stretching from Taupo, to Gisborne, to Kaitaia. It also order-picks [] for the entire North Island from Auckland.

65. Polarland is likely to offer significant constraint to the merged entity and offer a strong option for any manufacturers or retailers that wish to switch following the merger. [

]

Conclusion on Constraint from Current Competitors

66. Given that there are few contracts of significant size in the North Island, there are few competitors in this market. Despite this, the Commission considers that the ability of Polarland to expand will provide significant constraint.

Constraint from Potential Competition

67. The Commission considers that potential competition to the market, from new entry or expansion by existing market participants, can act as a constraint on the behaviour of the merged entity in that market. An assessment of conditions and barriers to entry is considered below. In addition, in order for the threat of market entry or expansion to be a sufficient constraint so as to alleviate concerns of market dominance, the Commission needs to be satisfied that entry or expansion in response to the exercise of market power will be likely, sufficient in extent, timely and sustainable.⁹

Conditions of Entry/Expansion

Capital Cost

68. Industry parties have advised the Commission that new entry would be most effectively implemented through the purchase or lease of a new facility. [] were of the view that facilities such as the Enza coldstores are old and inefficient to run. Newer facilities are attractive to potential clients as they project an image of cleanliness and efficiency.

69. The Commission has been advised that in general it is not cost effective to convert dry warehouses into chilled or frozen warehouses. Once the chilling machine has been purchased, the walls insulated, and the room segmented there is little or no cost saving. In addition, if the warehouse is to contain frozen goods, the floor must be heated, otherwise the soil freezes underneath and breaks up the floor.

70. The capital cost of entry is generally agreed by market participants to be around \$1000 per pallet space. This estimate accounts for everything the facility will need to be operational, including, *inter alia*, steelwork, insulation, office and amenities, racking, mechanical equipment and computers.

71. A facility of 3500 pallet spaces has been suggested as a reasonable size for new entry. If it is any smaller, then customers may question the ability of the facility to cope with unexpected increases in stock. Although temporarily hiring space in a competitor's facility is an option, this is costly and is not a dominant strategy for long-term sustainability in the market. The capital cost is therefore likely to be around \$3.5-4 million, for entry on a reasonable scale.

⁹ Together, the test of whether entry is *likely*, of sufficient *extent*, *timely*, and *sustainable* is collectively known as the "lets test".

72. The Commission has also been advised that entry can be implemented by contracting a firm to build a refrigerated warehouse, and then leasing it from that firm. This would avoid the need for significant outlay.

Inventory Systems

73. Compared to the bulk storage area of the market, the main point of difference is the level of the computer inventory system used. The turnover of product in retail order-picking is significantly higher than bulk storage and there are significantly more product ranges compared to manufacturer order-picking.

74. [

].

Key Personnel

75. The ability to provide an accurate and timely service requires competent staff in key positions. The personnel required must have a strong logistics background. This is why a firm switching from bulk storage to order-picking and, in particular, retail order-picking, may not necessarily be successful. [

]

76. Key personnel is not likely to constitute a significant barrier to entry. Personnel can be recruited as their contracts fall due, and a firm could obtain staff with the right competencies well within two years.

Barriers to Entry

Sunk Cost

77. The establishment of a new facility may involve significant sunk costs. Refrigerated warehouses are purpose built; they are not extensions or modifications to dry warehouses. The chance of losing a major customer can leave a firm exposed. However, refrigerated warehousing can be leased rather than purchased which is likely to limit the risk.

Reputation

78. When placing distribution with a third party, manufacturers and retailers place considerable reliance on that firm to carry out order picking in a timely and accurate manner. Incorrect orders can harm their reputations. Firms are not merely sensitive to price, but also value experience.

79. P&O has a well established reputation, as a result of having distributed for Woolworths for around twelve years. Polarland has a reputation deriving from its activities in Australia. Progressive expressed the view that, following the acquisition, P&O and Polarland would be the only firms that would be able to service its needs. There were no other firms with a proven track record in retail distribution.

80. Given that there are few retail contracts available, and that both Progressive and Foodstuffs have only recently begun out-sourcing refrigerated warehousing, it is not surprising that there are few firms with retail distribution experience. However, Eskimo moved into retail order-picking by gaining the Progressive contract. Prior to that it had

only done manufacturer order-picking. [

]

81. Woolworths did not express the same concerns as Progressive. It was of the view that although there are few immediate options in the refrigerated warehousing, there were dry goods warehouse operators with the necessary competencies. These included [], who both expressed interest when Woolworths tendered its business in 1998.
82. Therefore, while having an established reputation is important, it can be gained in other markets. Reputation is not, therefore, considered to be an insurmountable barrier.

The Lets Test

83. In making the assessment of constraints 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*, of sufficient *extent*, *timely*, and *sustainable*.

Likelihood and Sustainability of Entry

84. In order to be an effective constraint on incumbent market participants, entry into the market must be considered likely on commercial grounds. In addition, entry is likely only if there is a lasting economic incentive.
85. Up until 1998 the only firm providing retail order-picking services for supermarkets was P&O. P&O had been order-picking for Woolworths since 1988. Since 1998 Eskimo have entered the market by taking on Progressive's warehousing, and Polarland has recently acquired the order-picking business of Foodstuffs (Auckland). For this reason, the retail order-picking industry could be considered to be relatively young.
86. The successful entry of these two firms illustrates that entry is possible. Furthermore, Foodstuffs (Wellington) and Foodstuffs (South Island) continue to provide their own warehousing, which represents an opportunity for a new entrant.
87. Given the above examples of entry, it is likely a that firm could successfully enter the market. There are currently firms with the same logistics skill sets as Eskimo and Clelands that could enter if there was an economic incentive to do so. An approach by a large retailer would probably be sufficient in itself to encourage entry.
88. The Commission is of the view that, for the above reasons, entry is likely and sustainable.

Extent

89. If it is to constrain market participants, the threat of entry must be to such an extent as to cause the market participants to react in a significant manner.
90. Eskimo has advised that it uses around [] pallet spaces in Auckland to service the Progressive account, while P&O uses around [] for Woolworths. Therefore, if entry was to occur it would have to be at a reasonable level, such that it was able to service a contract.
91. The Commission considers that it is likely entry will be achieved to the extent that would significantly constrain the merged entity.

Timeliness

92. To 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. 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.
93. The Commission is of the view that entry could be achieved in a reasonably timely manner for those entering the market through a green-field venture, and especially for fringe competitors. The Commission has been advised that a green-field entry could be achieved in 5-7 months.
94. For fringe competitors (those already with refrigeration facilities), preparing their current facilities for entry could be achieved within 1-2 months. All that would be required, would be to empty chillers or freezers and then replace the racking (if required). Training and recruiting staff would take considerably longer although well within two years.
95. The Commission considers the timeliness requirement for the “Lets” test is satisfied.

Conclusion on Lets Test

96. The Commission considers all aspects of the “Lets” test are met.

Potential Entrants

97. The most likely new entrant would be a firm that currently specialises in manufacturer order-picking, through shifting the focus of its business to retail order-picking. This is because it would have the necessary facilities in place. However, as discussed earlier (in the market definition section) successful switching may not be as straight-forward as it would seem. This is because retail order-picking is considerably more complex and requires better inventory systems.
98. It has been suggested to the Commission that the most likely entrants may be logistic/transport firms such as Mainfreight and Linfox. These firms both have extensive dry warehouse operations and are understood to have the competencies in inventory systems necessary to be a strong competitor in contract refrigerated warehousing.
99. Mainfreight is a publicly listed logistics company, and owns 16 distribution centres with a combined area of around 738,000 square feet (which corresponds to around 40-50,000 pallet spaces). [

]

100. Linfox is an Australian company, which commenced business in New Zealand in 1990. Since that time it has built a logistic business that includes 13 dry warehouses collectively with around 1,000,000 square feet of storage area (which corresponds to around 60-70,000 pallet spaces). [

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101. [

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102. Another firm that could potentially enter the market is []. Woolworths has advised the Commission that when it last put its contract out to tender [] made a bid. [] has locations throughout the North and South Islands and currently does small manufacturer order-picking jobs. Although to service the contract it would have had to purchase or lease new warehouse facilities, Woolworths was of the view it had the necessary competencies to do the job. Woolworths still considers [] one of its options should it wish to switch from P&O.

103. It is also possible that an Australian cold logistics firm could enter the market. Currently, the market in Australia is shared among five providers, including P&O and Clelands. [

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Clelands, however, was of the view that other Australian firms would be hesitant about entering the market because it was considered small and not worth their while.

Conclusion on Constraint from Potential Entry

104. The Commission concludes that the threat of new entry is likely to provide a significant constraint on the merged entity.

Countervailing Power

105. Within the retail market there are only three large order picking contracts, with Progressive Enterprises, Foodstuffs (Auckland), and Woolworths. Currently, these are held by Eskimo, Polarland, and P&O respectively. For each firm, [

] This creates significant

countervailing power for the supermarkets, as losing these retail contracts would result in a [] fall in revenues.

106. One example of the power of these contracts is when [

]

107. The size of each contract would be sufficiently big to encourage a firm that tends to do more bulk storage to shift its focus to retail. As it is, there are many firms whose main focus is on bulk storage but with the competencies to order pick for retail contracts. A supermarket contract would also create opportunities for an Australian firm entering the market or for further expansion by Polarland, the Cleland owned facility in Auckland. [

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108. In addition, supermarkets could constrain the merged entity by the threat of returning distribution in-house. Up until recently, Woolworths was the only supermarket chain out-sourcing centralised warehousing order-picking. Foodstuffs (Wellington) and Foodstuffs (South Island) do their own distribution, while Foodstuffs (Auckland) and Progressive only recently switched to out-sourced warehousing.

109. Although returning distribution in-house is probably not a first choice given the general move towards out-sourcing, it would be an option if the merged entity was to raise prices unreasonably or lower service significantly. [

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110. Foodstuffs (South Island) does its own centralised warehousing. It started this by purchasing one of the Enza coldstores then adding on a freezer facility. [

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111. [

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Conclusion on Countervailing Power

112. It is the view of the Commission that the countervailing power of customers is likely to provide considerable constraint on the merged entity.

Conclusion on the Market for the Provision of Refrigerated Warehousing and Order-Picking Services for Retail Customers in the North Island

113. The Commission notes that the merged entity would have a significant market share. Notwithstanding, the Commission is of the view that the ability of Polarland to expand its operation, the potential for new entry, and the countervailing power of customers are collectively likely to provide sufficient constraint, such that P&O will not acquire or strengthen dominance.

The Market for the Provision of Refrigerated Warehousing and Order-Picking Services for Retail Customers in the South Island

**Table 2:
Market Share Estimates for the South Island**

Firm	Capacity Used (pallets)	Market Share (%)
P&O	[]	[]
Eskimo	[]	[]
Sub-Total	[]	[]

Foodstuffs (South Island)	[]	[]
Total	[]	100

Constraint from Current Competitors

114. In the South Island there will no independent competitors following the merger. The next biggest firm in the market is Foodstuffs (South Island). However, it is unlikely Foodstuffs (South Island) would compete with the merged entity for other retail contracts. Nor would Progressive or Woolworths be likely to be interested in having their goods distributed by Foodstuffs. It does, however, highlight the ability of supermarkets to do their own centralised warehousing.

Constraint from Potential Competitors

115. The conditions and barriers to entry in the South Island market are analogous to those of the North Island, described in paragraphs 68-82. The Commission is also of the view that the “Lets” test for the South Island is met for the same reasons as described in paragraphs 83-96.

Potential Competitors

116. All of the potential competitors mentioned in paragraphs 97-104 apply to the South Island market as well. In addition, additional potential entrants have been identified in the paragraphs below.

117. Polarland is likely to be a potential competitor. Currently it order-picks for Foodstuffs in Auckland. Given its experience in retail-picking in New Zealand and in Australia, it is likely to represent a very attractive option for Woolworths or Progressive to encourage into the South Island. Furthermore, [

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118. Christchurch Coolstores is a well established firm that splits its operation between manufacturer order-picking and bulk storage. It has around [] pallet spaces in Christchurch. It has advised that [

] Christchurch Coolstores was of the general view that the acquisition would not significantly affect the market.

119. Avenue Coolstores is a smaller coolstore operator. It has capacity of around [] pallet spaces that it uses for manufacturer order-picking (around [] pallets) and bulk storage for primary goods (around []). [

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Countervailing Power

120. The analysis described in paragraphs 105 to 112 for the North Island market also applies to the South Island. The following points are noted:

- Supermarkets account for a substantial proportion of revenue, and each could encourage a fringe competitor into the market;

- Supermarkets could return distribution in-house. Currently, Foodstuffs (Wellington) and Foodstuffs (South Island) do their own distribution; and,
- Supermarkets could decentralise distribution (although this would probably not be as efficient).

121. It is further noted that if the merged entity were to attempt to exercise market power in the South Island against Progressive or Woolworths, it would risk losing the North Island business of the target firm.

Conclusion for the Market for the Provision of Refrigerated Warehousing and Order-Picking Services for Retailers in the South Island

122. It is the view of the Commission that, despite the lack of a strong competitor, the constraint provided by the potential for new entry and the countervailing power of consumers is sufficient to allay any dominance fears. It is likely that Eskimo's exit from the industry will provide an opportunity for another firm to enter the market.

The Market for the Provision of Refrigerated Warehousing and Order-Picking Services for Manufacturers in the North Island

123. Market shares have been estimated based on approximate pallet space used for independent firms servicing manufacturing order-pick contracts. These figures are not publicly available and have been obtained by contacting each firm individually. Time constraints prevented the Commission contacting every operator in the market. For this reason the market share analysis is by no means exhaustive. The figure given for the merged entity is therefore likely to be overstated.

124. The market shares below do not include manufacturers that do their own distribution. The ability of manufacturers to do their own distribution will instead be considered later as a constraint due to countervailing power.

**Table 3:
Market Share for North Island Market**

Firm	Capacity Used (pallets)	Market Share (%)
P&O	[]	[]
Eskimo	[]	[]
Sub-Total	[]	[]

Polarland	[]	[]
Dandys	[]	[]
Owens	[]	[]
TCD	[]	[]
Others	No estimate	
Total	[]	100

Constraint from Current Competitors

125. The main competitor is likely to be Polarland. As discussed above, Polarland is a long established Australian-based firm, which entered the New Zealand market in 1996. Since its entry []

Polarland is likely to provide a strong constraint on the merged entity.

126. There are many other smaller players that are likely to provide a constraint on the merged entity, including firms such as Dandys, Owens, and TCD. Currently, these firms split their facilities between bulk storage, and manufacturer order-picking. Should the economic incentive arise, there is no reason why these firms could not shift their focus towards manufacturer order-picking rather than bulk storage.

127. [] advised that it had considered the likely effects of the acquisition and considered there were plenty of other coldstores that could satisfy its needs in the North Island. In particular, [] identified Whakatu Coldstores as being a suitable option for its distribution. Whakatu has around [] pallet spaces and is located in the Hawkes Bay. It is understood that Polarcold is a part owner in this facility.

Conclusion on Constraint from Current Competitors

128. The existence of strong competitors and their ability to easily expand their operations is likely to place considerable constraint on the merged entity.

Constraint from Potential Competitors

129. Manufacturer order-picking is not considered to be particularly difficult. All firms contacted either already do order-picking to some extent or were of the view they had the necessary competencies. The most likely new entrants are therefore current operators of coldstores for bulk storage.

130. It has been estimated that there is a capacity of around 150,000 pallet spaces in the North Island, mainly used for bulk storage. Given the favourable exchange rates for primary producers, produce is moving off-shore quickly and not being stored for long. For this reason, there is understood to be considerable excess capacity in bulk storage. This capacity could easily be used for manufacture order-picking.

Conditions of Entry/Expansion

131. The conditions of entry are similar to those for retail order-picking, described in paragraphs 68 to 76. A coldstore is required, as too a suitable inventory system, and appropriate staff would need to be hired. However, given the lower complexity of manufacturer order-picking compared to retail order-picking, entry is considerably less onerous.

Potential Entrants

132. Logistics firms such as Linfox and Mainfreight described in paragraphs 98 to 101 are likely to be potential entrants to the market. These firms have the necessary competencies, experience, and reputation to enter the market successfully.
133. As noted above, owners of cold storage currently being used for bulk storage are potential entrants.

Conclusion on Potential Entrants

134. The existence of potential entrants and low barriers to entry for owners of coldstores are likely to place a considerable constraint on the merged entity.

Countervailing Power

135. Manufacturers appear to have a degree of countervailing power through their ability to return distribution to in-house. Several manufacturers still retain this function, including Tegel, Tip Top, Country Foods, and Mainland. There is no reason why, if the merged entity attempted to exercise market power, a manufacturer could not return distribution to in-house.

Conclusion on Countervailing Power

136. The ability of manufacturers to return distribution to in-house is likely to place considerable constraint on the merged entity.

Conclusion on the Market for the Provision of Refrigerated Warehousing for Order-Picking for Manufacturers in the North Island

137. It is the view of the Commission that the constraint provided by current competitors, potential competitors, and the countervailing power of customers is sufficient to allay any dominance concerns.

The Market for the Provision of Refrigerated Warehousing and Order-Picking Services for Manufacturers in the South Island

138. The market shares are based on figures supplied to the Commission from each firm in the market. Again, as for the North Island market, the list of competitors is not exhaustive. The market share estimate for the merged entity is therefore likely to be overstated.

Table 4:
Market Share for South Island Market

Firm	Capacity Used	Market Share (%)
P&O	[]	[]
Eskimo	[]	[]
Sub-total	[]	[]
Polarcold	[]	[]

Avenue Coolstores	[]	[]
Christchurch Coolstores	[]	[]
Amalgamated Food Distributors	[]	[]
Others	Unknown	
Total	[]	100

Constraint from Current Competitors

139. The main competitor in the market is likely to be Polarcold. It is a long established firm having entered the market in 1956. It currently has around [] pallet spaces of capacity in the Canterbury region with further capacity of around [] located in Timaru and Dunedin. Most of this capacity is used for bulk storage but could easily be used for manufacturer order-picking if the opportunity existed.
140. Christchurch Coolstores is also likely to provide significant constraint. It has around [] pallet spaces of capacity in the Canterbury region. Although it currently uses only around [] pallet spaces for manufacturer order-picking it could easily expand the order-picking side of its business.
141. []

Constraint from Potential Competitors

142. As mentioned in paragraph 130, there is considerable capacity in the bulk storage market that could be used for manufacturer order-picking in the South Island.

Conditions and of Entry/Expansion

143. The same conditions of entry and expansion as discussed in paragraph 131 above, apply to the South Island market.

Countervailing Power

144. Manufacturers possess the same countervailing power as discussed in paragraph 136.

Conclusion on the Market for the Provision of Refrigerated Warehousing and Order-Picking Services for Manufacturers in the South Island

145. Much of the analysis for the North Island market applies to the South Island market. That is, the existence of current competitors, potential competitors, and the countervailing power of customers is likely to allay any dominance concerns.

OVERALL CONCLUSION

146. The Commission has considered the likely effects of the acquisition in the following markets:
- The market for the provision of refrigerated warehouses and order-picking services for retail customers in the North Island;
 - The market for the provision of refrigerated warehouses and order-picking services for retail customers in the South Island;

- The market for the provision of refrigerated warehouses and order-picking services for manufacturer customers in the North Island; and,
- The market for the provision of refrigerated warehouses and order-picking services for manufacturer customers in the South Island.

147. On balance, it is the view of the Commission that there are sufficient constraints in each of the markets such that dominance will not be acquired or strengthened. The main factors considered were:

- Constraint from current competitors, and the ability of such competitors to expand;
- The potential of new entry;
- Ability of customers to revert to in-house distribution; and,
- Countervailing power of the supermarkets.

148. Having regard to the various elements of section 3(9) of the Act, and all other relevant factors, the Commission concludes that it is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in any market.

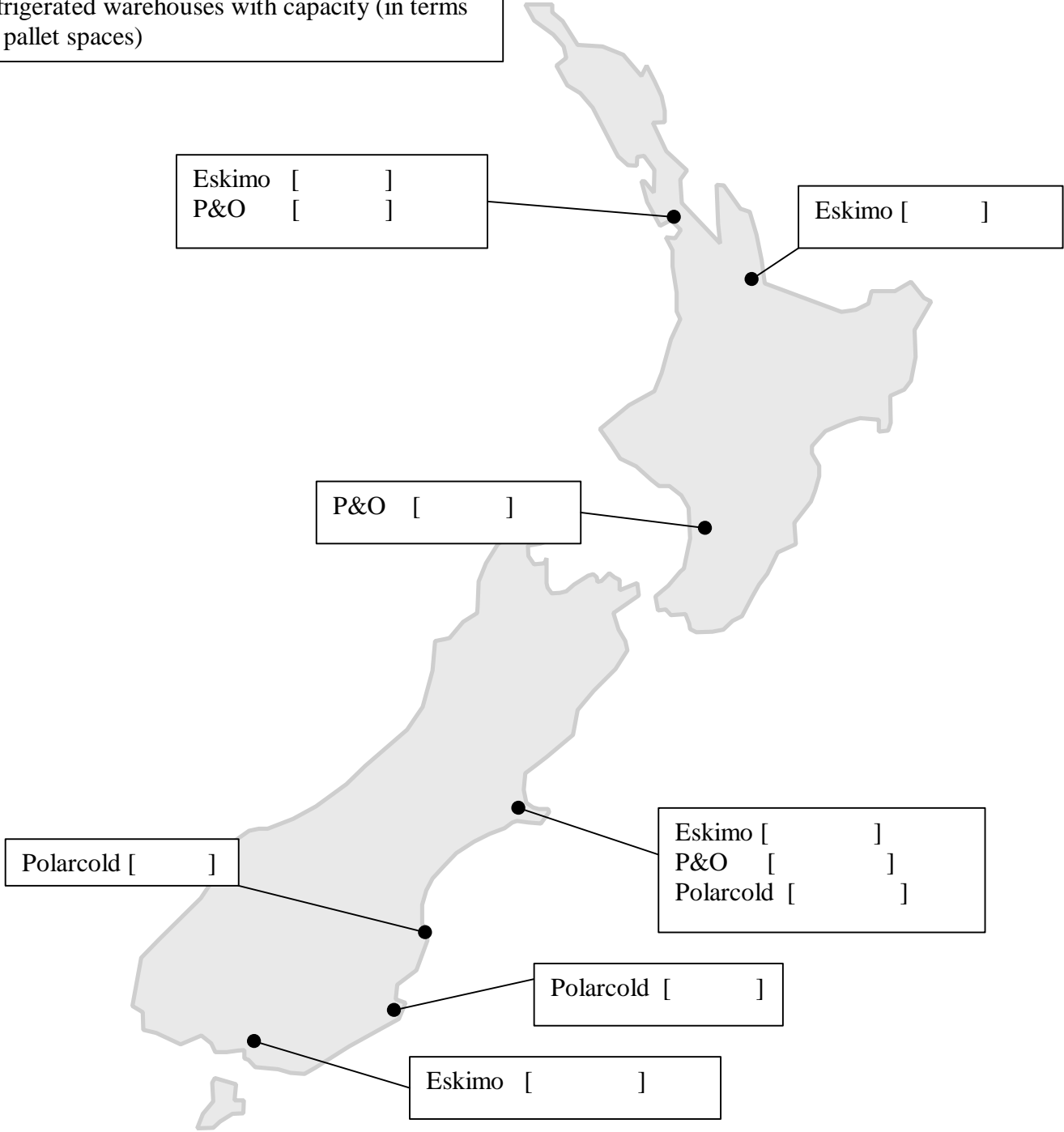
DETERMINATION ON NOTICE OF CLEARANCE

149. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by P&O of all or some of the business or assets of Eskimo, but excluding any assets of the Perishables Air Freight Forwarding business.

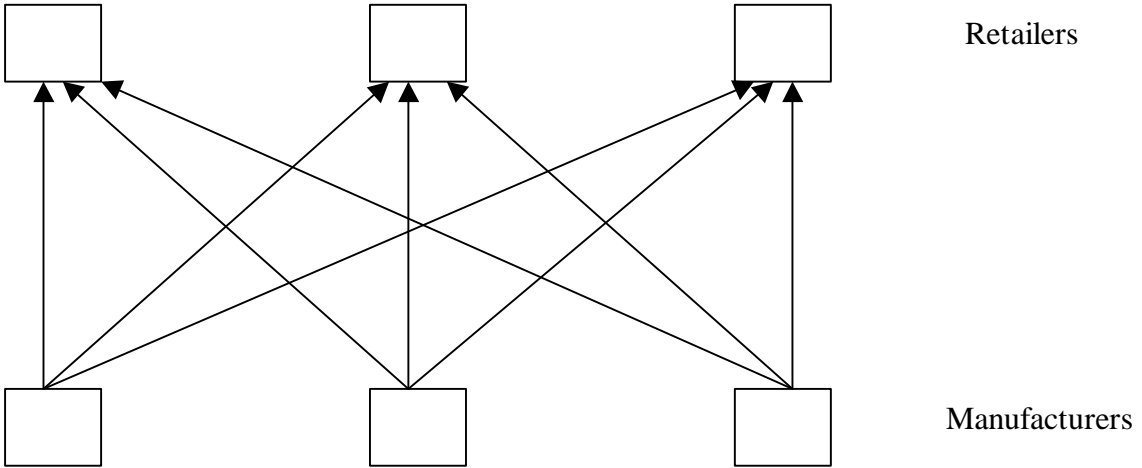
Dated this 16th day of February 2001

John Belgrave
Chair

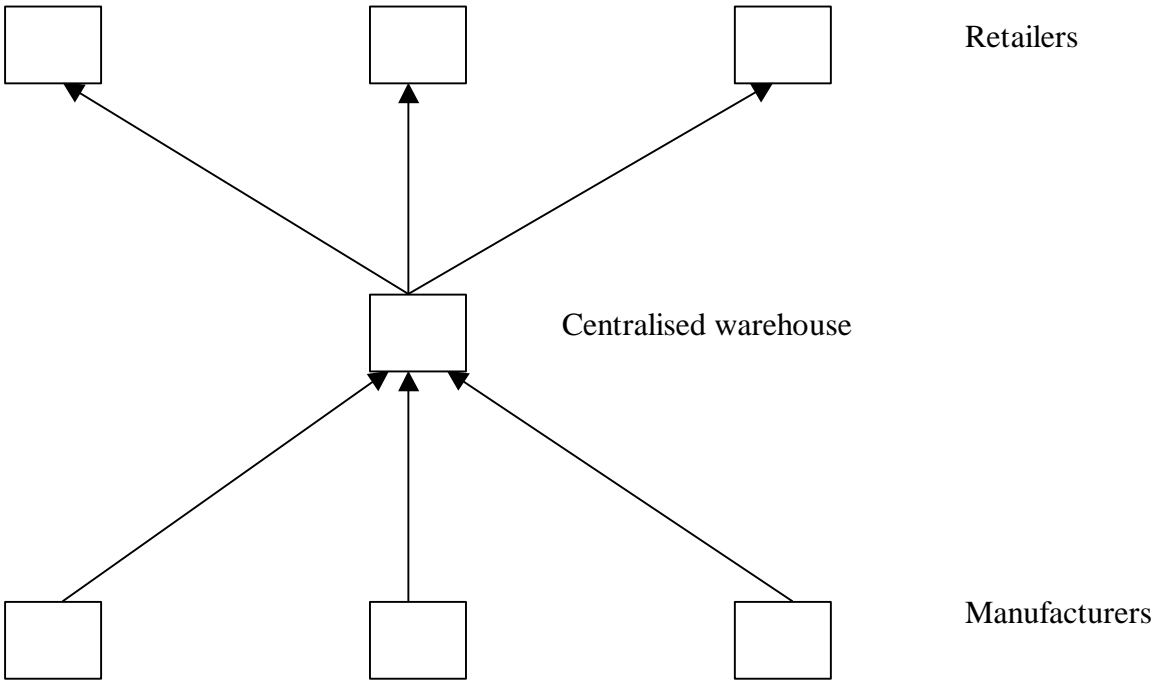
APPENDIX A: Location of Eskimo/P&O refrigerated warehouses with capacity (in terms of pallet spaces)



Appendix B: Centralised Warehousing

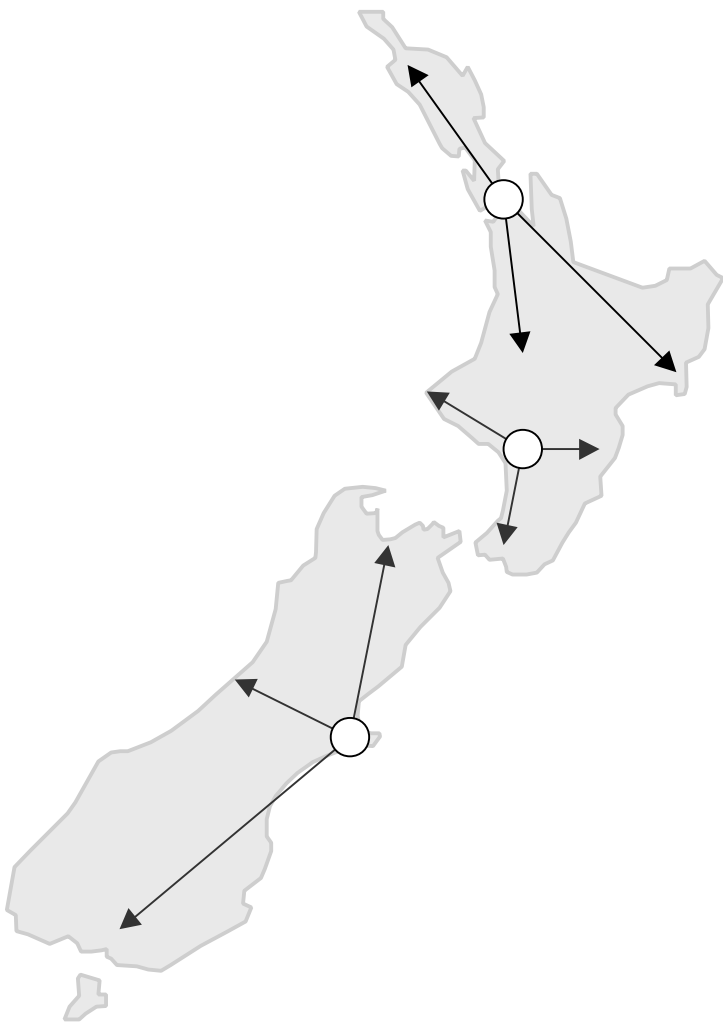


= 9 Trips



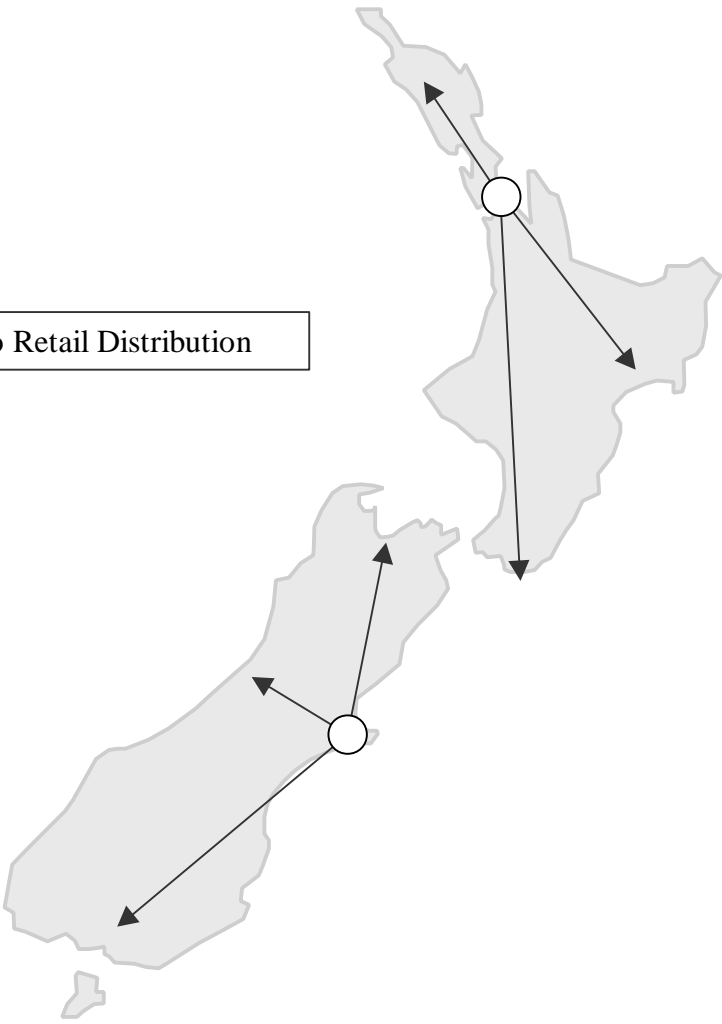
= 6 trips

APPENDIX C: Distribution diagrams



P&O Retail Distribution

Eskimo Retail Distribution



Polarland Retail Distribution



Foodstuffs (Wellington) / Foodstuffs (South Island)

