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COMMERCE COMMISSION

Decision No. 617

Determination pursuant to the Commerce Act 1986 in the matter of an application for Proposal

NEW ZEALAND POST LIMITED

and

SALMAT INTERNATIONAL PTY LIMITED

The Commission:	David Caygill Denese Bates QC Anita Mazzoleni
Summary of Application:	The acquisition of shares in JV Co (a new company to be formed) by New Zealand Post Limited and Salmat International Pty Limited, or their subsidiaries, in approximately equal proportions; and the acquisition by JV Co of the assets of the unaddressed mail delivery businesses of Letterbox Channel Limited and Deltarg Distribution Systems Limited.
Determination:	Pursuant to Section 66 (3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition
Date of Determination:	12 September 2007

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EXECUTIVE SUMMARY

E1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 06 August 2007. The notice sought clearance for the acquisition of shares in JV Co (a new company to be formed) by New Zealand Post Limited (NZ Post) and Salmat International Pty Limited (Salmat), or their subsidiaries, in approximately equal proportions; and the acquisition by JV Co of the assets of the unaddressed mail delivery businesses of Letterbox Channel Limited (LBC) and Deltarg Distribution Systems Limited (Deltarg).

E2. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the national market for the distribution of unaddressed mail.

E3. The Commission considers the likely counterfactual to be the status quo.

E4. Presently, there are three national providers of unaddressed mail distribution services: LBC, Deltarg and PMP Distribution Limited (PMP). In the factual, based on the volume of unaddressed mail distributed in the 2006 financial year, the combined entity will have a market share of [ ] % and PMP will have a market share of [ ] %.

E5. The Commission is of the view that post-acquisition the combined entity is likely to continue to face constraint from its existing competitor, PMP. Furthermore, PMP has the ability to expand readily and exert additional constraint on the combined entity in the factual.

E6. The Commission is of the view that entry conditions are not onerous and that new entry into the market on a significant scale is sufficiently likely and timely to constrain the combined entity post-acquisition.

E7. In respect of constraints from outside the market, the Commission considers it is likely that the combined entity would face some degree of constraint from other forms of print advertising, such as metropolitan newspapers, and other advertising channels, such as television. However, because of the logistical difficulties in co-ordinating national distribution on a region-by-region basis, the Commission is of the view that the combined entity is unlikely to face significant constraint from regional unaddressed mail distributors.

E8. The Commission is of the view that vertical integration concerns are unlikely to be enhanced in the factual scenario; LBC is currently vertically-integrated with NZ Post. Presently PMP has the option of contracting for rural delivery services through either NZ Post or Rural Couriers Society Limited (Coural). This will not change post-acquisition.

E9. The Commission considers that the scope for unilateral market power is unlikely to be enhanced in the factual, as JV Co will continue to face constraint from PMP, potential competition in the form of regional operators, and to a lesser extent, other advertising options.

E10. Despite the proposed transaction effectively reducing the number of players in the relevant market from three to two, the Commission considers that the scope for co-ordinated market power is unlikely to be enhanced by the proposed acquisition because both JV Co and PMP will continue to face constraint from potential competition, and to a lesser extent, other advertising options.

E11. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in any market.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 06 August 2007. The notice sought clearance for the acquisition of shares in JV Co (a new company to be formed) by New Zealand Post Limited and Salmat International Pty Limited, or their subsidiaries, in approximately equal proportions; and the acquisition by JV Co of the assets of the unaddressed mail delivery businesses of Letterbox Channel Limited and Deltarg Distribution Systems Limited.

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 21 September 2007.
3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.[1]

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal has, or is likely to have, the effect of substantially lessening competition in the market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

> "We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual."[3]

7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.
[2] *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.
[3] *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, (2004) 11, TCLR 347, Hansen J and K M Vautier, Para 42.

not minimal.[4] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any give case.

9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

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

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

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

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

THE PARTIES

New Zealand Post Limited (NZ Post)

12. NZ Post is a state-owned enterprise under the State-Owned Enterprises Act 1986. Its main business activities include business and personal communications, physical goods distribution and logistics, banking and payments, and document and information management.

[4] *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

Letterbox Channel Limited (LBC)

13. LBC is a wholly-owned subsidiary of NZ Post, which provides distribution services for unaddressed mail (encompassing both delivery services and micromarketing services) throughout New Zealand.

Salmat International Pty Limited (Salmat)

14. Salmat is listed on the Australian Stock Exchange, and is one of Australasia's major direct customer communications companies.

Deltarg Distribution Systems Limited (Deltarg)

15. Deltarg is a wholly-owned subsidiary of Salmat, which provides national unaddressed mail distribution services (encompassing both delivery services and micromarketing services).

OTHER PARTIES

PMP Distribution Limited (PMP)

16. PMP is a wholly-owned subsidiary of PMP (NZ) Limited, and encompasses services relating to the delivery of unaddressed mail as well as micromarketing services for advertisers on a nationwide basis. PMP (NZ) Limited is listed on the Australian Stock Exchange and is also involved in web printing, short-run printing, and magazines in New Zealand.

Rural Couriers Society Limited (Coural)

17. Coural is a co-operative company, owned by independent rural delivery contractors throughout New Zealand. These rural delivery contractors (who also deliver for NZ Post) provide a national network for the delivery of unaddressed mail, parcels, letters, milk, bread, newspapers, and a wide variety of farming commodities.[5]

Circular A1 Distribution (NZ) Limited (Circular Distributors)

18. Circular Distributors is a privately-owned company that established delivery services for unaddressed mail in Auckland in 2000. Since this time it has expanded to provide delivery services for unaddressed mail throughout the upper North Island.

INDUSTRY BACKGROUND

Distribution of Unaddressed Mail

19. Both LBC and Deltarg are primarily involved in the distribution of unaddressed mail. Much of the unaddressed mail they carry is advertising material for retailers, although it also includes community newspapers and, to some extent, community information.

20. The distribution of unaddressed mail is co-ordinated through a national network of delivery runs serviced by "walkers". Supervisors are responsible for overseeing the group of delivery runs within their specific geographic region, and in turn report to field managers based at a central location.

21. Supervisors receive unaddressed mail from a distribution hub, such as a warehouse or distribution centre, and allocate the unaddressed mail to walkers

[5] http://www.coural.co.nz/profile.html

in their region. Typically, a walker will cover a delivery run which consists of up to 300 households.

22. Unaddressed mail is delivered on specified days of the week, known as delivery windows, which span one or two days. LBC, Deltarg and PMP operate similar delivery windows and deliver unaddressed mail at the middle and end of the week.

23. Rural deliveries are not serviced by these unaddressed mail distribution networks. Instead, rural deliveries are sub-contracted to rural delivery drivers through Coural or NZ Post.

24. In recent years distributors have incorporated micro-marketing as part of their portfolio of services. Micro-marketing uses geo-demographic tools and census data to identify niche target audiences, thus reducing unnecessary production and distribution costs.

The Advertising Industry

25. Unaddressed mail is one of a number of different channels used by advertisers to communicate to an audience. It is used widely for sales promotions and customer acquisition, predominantly for retail products, fast moving consumer goods, and community notices.

26. Other advertising channels include television, such as free-to-air and pay; radio; newspapers; unaddressed mail; magazines; out of home media, such as billboards, bus-stops, mobile media, ambient media etc; telemarketing; addressed mail; cinema; and interactive advertising, including the Internet, email marketing and SMS/text messaging.

27. An advertiser's choice of advertising channel will depend on the message and the advertiser's (or its agency's) perception of what is most appropriate to achieve their objectives - whilst the different advertising channels all serve the same ultimate purpose of conveying a message to customers, they each have different characteristics.

PREVIOUS COMMISSION DECISIONS

28. The Commission has not previously considered delivery services for unaddressed mail. The Commission's most recent Decision in which unaddressed mail was discussed concerned community newspaper publishing services.[6]

MARKET DEFINITION

29. The Act defines a market as:

> "… a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them."[7]

30. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale

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[6] Decision 561, *Fairfax New Zealand Limited and Times Media Group Limited*, 14 October 2005.
[7] Section 3(1) of the Commerce Act 1986.

remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

31. The Commission has stated in its Mergers and Acquisitions Guidelines:

> "For competition purposes, a market is defined to include all those suppliers and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce or who could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition."[8]

32. The Applicants are both engaged in the delivery of unaddressed mail. They have stated that unaddressed mail is one of many advertising channels through which advertisers get their message to market, that there is significant competition between various advertising channels, and that advertisers can and do move their advertising spend freely between them. Their list of advertising channels include television (free-to-air and pay); radio; newspapers; unaddressed mail; magazines; out of home media (billboards, bus-stops, mobile media, ambient media etc); telemarketing; addressed mail; cinema; and interactive advertising (including the Internet, email marketing and SMS/text messaging).

33. The Applicants note that in Decision 561, the Commission included unaddressed mail in the print advertising market. This was one of the markets the Commission used to assess the competition implications of Fairfax acquiring Times Media where the particular focus was on community newspapers. The applicants also note that the Commission stated that other forms of advertising also provide some constraint on print advertisers.

34. In their Clearance Application, the Applicants submitted that the market could be defined as broadly as an advertising market …

> "The Applicants acknowledge that the Commission is likely to take the view that a narrower market definition would better highlight the competitive impact of the proposed Acquisition ... {T}he Applicants consider that the appropriate market definition is a national market for print advertising which includes:
>
> a) unaddressed mail; and
> b) advertising through metropolitan and community newspapers (display advertising and inserts)."

35. The Applicants go on to state that "even on the narrowest possible market definition (a national market for the delivery of unaddressed mail and related services) … the acquisition does not raise competition concerns". The Applicants' views are considered below.

Functional and Product Dimensions

36. As described above, the Commission attempts to define a market in a way that best assists the analysis of the competitive impact of the acquisition under consideration. In this instance, the acquisition involves two businesses whose principal activity is the delivery of unaddressed mail to households by utilising

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[8] Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

their delivery networks. Much of the unaddressed mail they carry is advertising material for retailers, although it also includes community newspapers and, to some extent, community information.

37. [ ] estimated that the delivery function would account for approximately 50 % of the cost of getting the advertising brochure (or leaflet, catalogue, coupon or sample) to the household. Design and printing are other significant contributors to the total cost. Demand for the delivery function is predominantly derived from the demand for advertising by way of unaddressed mail.

38. Consequently, if advertisers were to switch away from unaddressed mail to other forms of advertising it would have an important detrimental impact on those providing the distribution component. Distributors therefore have an incentive to ensure that their prices do not rise, and their level of service does not fall, to the extent that unaddressed mail becomes a relatively inefficient advertising channel. However, this general incentive is not sufficient in itself to warrant placing the distribution of unaddressed mail into a broader advertising market for the purpose of competition analysis.

39. For the Commission to use the broader market definition it would have to be satisfied that (in terms of the SSNIP test) it would not be profitable for a hypothetical sole provider of unaddressed mail advertising to increase prices by a small yet significant and non-transitory amount because it would result in sufficient numbers of advertisers switching to another advertising channel and that would make the price increase unprofitable.

40. In effect the Applicants have not only suggested that advertising by way of unaddressed mail competes strongly with other forms of advertising, but also that this competition in itself constrains providers of component parts of the unaddressed mail service (such as the delivery function) from, for instance, charging higher than competitive prices.

41. The Commission has given careful consideration to these suggestions. It considers that the following factors are relevant to its consideration:

- whilst advertisers canvassed by the Commission have some flexibility in how they apportion their advertising budget, most were of the view that unaddressed mail advertising is critical to their success. Other advertising channels are seen as complementary to, rather than a substitute for, unaddressed mail;
- to some extent inserts into community newspapers provide a reasonable substitute, as they have a distribution coverage that is similar to that of advertising brochures delivered separately (approximately 100 % of households);
- metropolitan newspapers do not provide a reasonable substitute, as their delivery networks do not allow distribution at the level of coverage required by unaddressed mail advertisers e.g., the New Zealand Herald only has [ ] % coverage in the Auckland region, whilst the Whakatane Beacon only has [ ] % coverage in the Whakatane region;
- as the distribution function accounts for only a proportion (approximately 50 %) of the total cost of unaddressed mail advertising, a relatively large increase in distribution prices (say, a SSNIP of 5 %) would flow through

to form a smaller percentage increase for the total cost of unaddressed mail advertising (in this case, a less significant price increase of 2.5 %). A less significant price increase, of 2.5 % for example, may not be sufficient to induce unaddressed mail advertisers to switch to another advertising channel, in which case inter-advertising channel competition is unlikely to prevent unaddressed mail distributors from increasing their prices by a "small yet significant" amount;

- the competitive constraint currently faced by a distributor appears to derive to a much greater extent from fellow distributors than from the flow on effects of competition at the advertising channel level; and
- the main focus of the Commission's analysis in this case is the competition implication for the distribution of unaddressed mail, rather than what may be a flow-on effect for advertisers in general.

42. Accordingly, the Commission considers that a "*distribution of unaddressed mail*" product and functional market best assists the analysis of the competitive impact of the current merger proposal.

Geographic Dimensions

43. LBC, Deltarg and the other principal distributor of unaddressed mail, PMP, operate distribution networks which are close to being national in scope, covering the major metropolitan areas throughout New Zealand, but excluding PO Box, Private Bag and rural delivery services.

44. Presently, PMP and Deltarg contract with LBC to provide PO Box, Private Bag and rural delivery services. In turn, LBC contracts with NZ Post to provide these services for PMP, Deltarg and LBC. Whilst NZ Post provides the PO Box and Private Bag delivery services, it sub-contracts with rural delivery drivers to provide the rural delivery service.

45. The majority of unaddressed mail requires national distribution. However, it is recognised that a significant amount (including community newspapers) are only delivered in particular regions. Each of the three national distributors compete for this regional business and in some areas they also face competition from local distributors. Consequently, in respect of regional delivery, competition is either greater than that for national delivery or, if there are no local distributors in the region, matches that for national delivery.

46. The Commission therefore considers that if competition concerns were to arise from the acquisition, those concerns will be likely to be greater in respect of national delivery than for regional delivery. If the acquisition does not result in a substantial lessening of competition in the national market, it is very unlikely to in any regional market.

47. Accordingly, the Commission has focussed on the *national market* in its assessment of the competition effects of the acquisition.

Temporal Dimensions

48. There can be occasions where it is appropriate for a temporal dimension to form part of the market definition, particularly where the competitive effects can vary over time.

49. The Commission gave consideration to the fact that the distribution networks deliver only twice, or perhaps three times a week, and that many advertisers

require delivery on a particular day of the week. Advertisers who want a Friday delivery would not be able to utilise a distributor who delivers only on Sunday and Wednesday, for example.

50. The Commission is satisfied, however, that distributors are readily able to change (or add to) their delivery days to meet demand. Consequently the Commission considers that it is not necessary to include a temporal dimension in its market definition.

Conclusion on Market Definition

51. The Commission has concluded that the relevant market for the consideration of this Application is the *national market for the distribution of unaddressed mail*.

COUNTERFACTUAL AND FACTUAL

52. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).[9] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

53. In the factual scenario JV Co (a new company) will be formed and NZ Post and Salmat, or their subsidiaries, will acquire shares in JV Co. In turn, JV Co will acquire the assets of the unaddressed mail delivery businesses of LBC and Deltarg.

54. The Applicants submitted that both LBC and Deltarg are marginally profitable businesses [ ]. In this respect, the proposed joint venture aims to [ ].

Counterfactual

55. The Applicants submitted that in the counterfactual LBC and Deltarg would continue to own and operate their unaddressed mail delivery businesses. The Commission considers that, critically, the two businesses will remain separate from each other, and will compete against each other, in the counterfactual.

COMPETITION ANALYSIS

Existing Competition

56. The Applicants submitted that the combined entity will face constraint from existing competition, in the form of PMP, and from smaller regional/local unaddressed mail operators.

57. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

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[9] *Air New Zealand & Qantas Airways Ltd v Commerce Commission* (No.6), (2004), 11, TCLR 347 Hansen J and KM Vautier, Para 42.

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

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

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

60. Table 1 shows the estimated market shares for the unaddressed mail market. Market shares presented are for both volume and revenue figures for the 2006/07 financial year.

Table 1: Estimated Market Shares of the Unaddressed Mail Market (2006/07 FY)

	Volume of Unaddressed Mail Delivered		**Revenue**	
Distributor	**Millions of Items**	**Market Share (%)**	**Millions of Dollars**	**Market Share (%)**
LBC	[ ]	[ ] %	[ ]	[ ] %
Deltarg	[ ]	[ ] %	[ ]	[ ] %
JV Co.	*[ ]*	*[ ] %*	*[ ]*	*[ ] %*
PMP	[ ]	[ ] %	[ ]	[ ] %
TOTAL	**[ ]**	**100 %**	**[ ]**	**100 %**

Source: Industry Participants

61. Table 1 indicates, by proportion of the volume of unaddressed mail delivered, LBC and Deltarg currently have market shares of [ ] % and [ ] % respectively, which will combine to give JV Co a market share of [ ] % in the factual. There is a marginal difference when assessing market shares in context of revenue; JV Co will have a market share of [ ] % in the factual – [ ] % of which would be contributed by LBC, and [ ] % of which would be contributed by Deltarg.

62. The three-firm concentration ratio is 100 % in both the factual and counterfactual. This falls outside the Commission's safe harbour guidelines.

63. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission now turns to consider the behaviour of the businesses in the market.

Competitive Impact of the Merger

64. The proposed acquisition will reduce the number of existing competitors in the unaddressed mail market from three to two. However, the Applicants submitted that JV Co will continue to face constraint from PMP in the factual.

65. Industry participants advised the Commission that the market is characterised by few large, national advertisers (usually retail chain-stores) that account for a significant proportion of the total volume of unaddressed mail delivered. These national advertisers typically let contracts for the delivery of their unaddressed mail on an annual or bi-annual basis.[10] [11] [12] Industry participants informed the Commission that distributors regularly compete against each other for these contracts; recent examples of contracts put out for tender include [ ].

66. The Applicants advised they have lost several key customers to PMP, including [ ], which switched to PMP because PMP could offer it a discount package for both printing and distribution.[13]

67. PMP confirmed with the Commission that it has grown its market share over the past three years by winning customers from Deltarg and LBC. PMP considers it has several competitive advantages over the combined entity: its ability to offer printing and distribution packages to its customers; [ ] which ensure greater delivery accuracy; and its micro-marketing service. Furthermore, through its Australian parent, it can bid against the combined entity for both New Zealand only and trans-Tasman contracts.

68. To this end, the Commission considers that it is likely that PMP will continue to act as a constraint on the combined entity in the factual.

Expansion by Existing Competitors

69. The Applicants submitted that there are few constraints on the ability of existing competitors to expand. Delivery density can be improved by increasing the number of unaddressed mail items delivered in one drop, and capacity can be increased by increasing the number of walkers[14] or, potentially, by opening a new delivery window or windows.

70. PMP advised the Commission it could readily expand to accommodate an additional [ ] % increase in the number of items delivered utilizing its existing delivery network. Above that, it could increase its capacity without incurring significant costs by opening new delivery windows or increasing its number of walkers.

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[10] For example, [ ].

[11] Industry participants advised the Commission these contracts tend not to be exclusive. [ ] advised the Commission [ ] contracted with LBC for its weekly national unaddressed mail delivery. However, it also used [ ] to deliver additional unaddressed mail for special campaigns, such as store openings and Christmas sales promotions.

[12] Some advertisers negotiate with unaddressed mail distributors on an informal basis, for example [ ].

[13] Other customers lost to PMP within the last two years include [ ]; conversely, PMP lost [ ] to Deltarg and LBC during the same period.

[14] Industry participants advised the greatest constraint on network capacity is the volume of items able to be carried by a walker. Deltarg and PMP advised the Commission this constraint can be easily overcome by reducing the size of the delivery run.

71. The Commission therefore considers it is likely that PMP has the ability to expand and exert additional constraint on the combined entity post-acquisition.

Conclusion on Existing Competition

72. The Commission considers that the combined entity is likely to continue to face constraint from its existing competitor, PMP, post-acquisition. Furthermore, the Commission is of the view that PMP has the ability to expand and exert additional constraint on the combined entity in the factual.

73. Accordingly, the Commission concludes that post-acquisition, the combined entity is likely to continue to face constraint from its existing competitor, PMP, in the national market for the distribution of unaddressed mail.

Potential Competition

74. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try.

75. The Applicants submitted that the ease with which a new player could enter the market would continue to act as a constraint on the combined entity. The Applicants consider barriers to entry to be low, although do not consider potential entry to be likely due to low returns in the market.

76. The Applicants submitted barriers to entry are lower for local/regional distribution than national distribution. For a local/regional service, entry requirements include a team of walkers, a truck to distribute product and a shed or garage to store product, and administration tools. Entry at a national level would require access to more depots, trucks, supervisors and walkers and support staff.

77. Doug Patel, Director, Circular Distributors advised the Commission that Circular Distributors considers the key entry requirement to be [ ]. In terms of the requirement to establish a logistics network for the distribution of product, Circular Distributors advised [ ].

78. Industry participants also stipulated access to rural delivery would be integral to providing a national distribution network.

Entry Conditions

79. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market.

80. Industry participants spoken to by the Commission agreed with the Applicants' submission in terms of requirements for entry: a team of walkers and support staff, transportation, and storage. No-one spoken to by the Commission considered these requirements constitute significant barriers to entry into the unaddressed mail distribution market.

81. In respect of customer contracts, national advertisers spoken to by the Commission, such as [ ], stated there is not a substantial incumbent advantage in terms of bidding for distribution contracts and would welcome approaches from new entrants.

82. To provide a truly national distribution service a new entrant would need access to a rural delivery service. The principal provider of the service is NZ Post. However, Brian Plimmer, General Manager of Coural, advised the Commission that his company could also provide a new entrant with a full rural delivery service.

83. Consequently, the Commission considers that entry conditions are not such as to constitute a barrier that would hinder new entry in the factual scenario.

The "LET" Test

84. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:

- Likely in commercial terms;
- sufficient in Extent to cause market participants to react in a significant manner; and
- Timely, i.e. feasible within two years from the point at which market power is first exercised.

Likelihood

85. Although the Applicants did not nominate potential entrants in their Clearance Application, several national advertisers informed the Commission they consider Circular Distributors to be a potential entrant into the national unaddressed mail distribution market.

86. Circular Distributors advised that [ ]. It nominated two regional operators it considers to be potential entrants into the national market for distribution of unaddressed mail.

87. Deltarg advised the Commission it considers the most likely new entrant would be an existing regional player expanding into the national market. Deltarg itself entered the Auckland region de novo, and subsequently expanded into providing national unaddressed mail distribution services by winning a contract with a large national advertiser.

88. Circular Distributors [ ].

89. Following its de novo entry into the Auckland region in 2000, Circular Distributors expanded to provide unaddressed mail distribution services throughout the upper North Island. [ ].

90. For these reasons, the Commission considers entry from existing regional unaddressed mail delivery operators to be likely in the event of an exercise of market power by existing market participants post-acquisition.

<u>Extent</u>

91. In its discussion of existing competition, the Commission noted that the market is characterised by few, large national advertisers (usually retail chain-stores). These national advertisers account for a significant proportion of the total volume of unaddressed mail delivered. For example, in the factual [ ] will account for approximately [ ] % of JV Co's unaddressed mail volume.

92. As discussed previously, industry participants advised the Commission that new entry would most likely be facilitated through securing a contract with a large national advertiser. Thus by winning such a contract, a new entrant would take away a sizeable revenue stream from existing competitors.

93. Furthermore, once established within the market, a new entrant could readily expand without incurring significant additional capital costs. [ ] advised a new entrant would be incentivised to ensure it secures additional contracts with advertisers, in order to maximize the profitability of a newly established delivery network.

94. To this extent, the Commission considers new entry would be sufficient to act as a constraint on the combined entity post-acquisition in the national market for the distribution of unaddressed mail.

<u>Timeliness</u>

95. The Applicants submitted that new entry could be achieved in a relatively short time frame. For example, Deltarg expanded from a regional operation to a national operation within 16 months of initial start-up.[15]

96. Circular Distributors [ ].

97. The Commission is therefore of the view that new entry within two years is feasible in the national market for the distribution of unaddressed mail.

Conclusion on Potential Competition

98. The Commission is of the view that requirements to enter the national unaddressed mail delivery market are unlikely to constitute barriers that would hinder new entry in the factual.

99. The Commission considers that barriers to entry are low, and new entry is most likely to occur by an existing regional unaddressed mail distributor by securing a national contract with a key national advertiser.

100. As there are few, large national advertisers, by winning such a contract, a new entrant would take away a sizeable revenue stream from existing competitors. Furthermore, the Commission is of the view that a new entrant is unlikely to face barriers to expansion once in the national market.

101. The Commission considers that new entry is likely to occur well within two years.

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[15] Deltarg commenced business in July 1994 and made its first national delivery drop, for Avanti Cycles, in November 1995.

102. Accordingly, the Commission concludes that post-acquisition, new entry is likely, timely and sufficient in extent to act as a constraint on the combined entity in the national market for the distribution of unaddressed mail.

Other Constraints

Other Forms of Advertising

103. The Applicants submitted that the combined entity would continue to face constraint from other forms of print advertising and other advertising channels in the factual scenario.

104. In Decision 561, the Commission considered that although not in the same market, other advertising channels provided some degree of constraint on print advertising (encompassing newspapers and unaddressed mail). However, the Commission was of the view that other forms of advertising alone would not be sufficient to constrain the combined entity post-acquisition.

105. Advertisers canvassed by the Commission advised there is no other form of advertising which is a fully satisfactory substitute for unaddressed mail. Some advertisers said should the combined entity exercise market power and increase prices in the factual scenario, they would be likely to switch some of their advertising spend for unaddressed mail to other forms of advertising.

106. [ ] advised the Commission that following a 15-20 % price increase in unaddressed mail advertising in 2006 [ ] made a strategic decision to reduce its funding for unaddressed mail advertising by [ ] %, and reallocate this to television advertising. [ ] advised that similarly, [ ] has reduced its funding for unaddressed mail and reallocated this to display and insert advertising in metropolitan newspapers. Likewise, [ ] said [ ] recently decided unaddressed mail was not cost-efficient and so reallocated spend to television and newspaper advertising.

107. The Commission therefore considers that the combined entity will continue to face some degree of constraint from other forms of print advertising, such as metropolitan newspapers, and other advertising channels, such as television, in the factual scenario.

Regional Delivery Operators

108. Industry participants spoken to by the Commission advised national advertisers could not use regional delivery operators to distribute unaddressed mail. National advertisers are disinclined to break up national advertising campaigns for delivery on a region-by-region basis due to the associated logistical problems of liaising with multiple distributors.

109. [ ] advised the Commission [ ] used a combination of [ ] to deliver its unaddressed mail. [ ] said it was “the biggest disaster” as there was no integration between the delivery operators and there were regional inconsistencies that could not be resolved. Eventually, [ ] dropped the contract.

110. For these reasons, the Commission considers that post-acquisition, regional delivery operators are unlikely to act as a constraint on the combined entity in the national market for the distribution of unaddressed mail.

Vertical Integration

111. Vertical acquisitions are those that involve businesses operating at different functional market levels in the production of a particular good or service. Where a vertical acquisition also has horizontal implications, the Commission considers each aspect of the acquisition in its own right.

112. The Commission is of the view that, in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless market power exists at one of the affected functional levels. Where such a situation is found to exist, the Commission considers whether the acquisition would strengthen that horizontal position, or have vertical effects in upstream or downstream markets, and whether that change would substantially lessen competition.

113. As discussed earlier, in paragraph 44, neither PMP, Deltarg nor LBC distribute unaddressed mail to PO Boxes, Private Bags or to rural areas. PMP and Deltarg contract with LBC to provide all of these services, and in turn, LBC contracts with NZ Post to provide these services for LBC, PMP and Deltarg. Whilst NZ Post provides the PO Box and Private Bag delivery services, it sub-contracts with rural delivery drivers to provide the rural delivery service.

114. [

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115. The Commission notes that LBC is currently vertically integrated with NZ Post's rural delivery service and consequently any incentive NZ Post may have to favour its own distributor already exists.

116. Furthermore, PMP advised the Commission it has the option of contracting for rural delivery services through Coural. Both PMP and Deltarg have contracted with Coural in the past and Coural advised the Commission it will continue to bid against NZ Post for unaddressed mail delivery contracts in both the factual and the counterfactual.

117. For these reasons, the Commission considers it is unlikely that vertical integration effects will result in enhanced market power.

Unilateral and Co-ordinated Market Power

118. The Commission is of the view that the scope for unilateral market power is unlikely to be enhanced in the factual, as JV Co will continue to face constraint from PMP, potential competition in the form of regional operators, and to a lesser extent, other advertising options.

119. Despite the proposed transaction effectively reducing the number of players in the relevant market from three to two, the Commission considers that the scope for co-ordinated market power is unlikely to be enhanced by the proposed acquisition. Both JV Co and PMP will continue to face constraint from potential competition in the form of regional operators, and to a lesser extent, other advertising options.

120. Accordingly, the Commission concludes that the scope for both unilateral market power and co-ordinated market power is unlikely to be enhanced by the proposed transaction in the national market for the distribution of unaddressed mail.

OVERALL CONCLUSION

121. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the national market for the distribution of unaddressed mail.

122. The Commission considers the likely counterfactual to be the status quo.

123. The Commission considers that post-acquisition the combined entity is likely to continue to face constraint from its existing competitor, PMP. Furthermore, PMP has the ability to readily expand and exert additional constraint on the combined entity in the factual.

124. The Commission is of the view that requirements for entry into the national unaddressed mail delivery market are unlikely to constitute barriers that would hinder new entry in the event of an exercise of market power in the factual. The Commission considers that potential competition, in the form of an existing regional unaddressed mail distributor, is likely, timely and sufficient in extent to constrain the combined entity post-acquisition.

125. In respect of constraints from outside the market, the Commission considers it is likely that the combined entity would face some degree of constraint from other forms of print advertising, such as metropolitan newspapers, and other advertising channels, such as television. However, because of the logistical difficulties in co-ordinating a number of regional distributors to provide national coverage, the Commission is of the view that regional distributors in their present form are unlikely to provide an effective constraint to the combined entity in the relevant market.

126. The Commission is of the view that vertical integration effects are unlikely to enhance market power in the factual scenario; LBC is currently vertically integrated with NZ Post and this will not change under the acquisition. In addition, regarding rural delivery services, PMP will continue to have the option of contracting with Coural post-acquisition.

127. The Commission is of the view that the scope for unilateral market power is unlikely to be enhanced in the factual, as JV Co will continue to face constraint from PMP, potential competition in the form of regional operators, and to a lesser extent, other advertising options. Despite the proposed transaction effectively reducing the number of players in the relevant market from three to two, the Commission considers that the scope for co-ordinated market power is unlikely to be enhanced by the proposed acquisition because both JV Co and PMP will continue to face constraint from potential competition, and to a lesser extent, other advertising options.

128. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in any market.

DETERMINATION ON NOTICE OF CLEARANCE

129. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition the acquisition of shares in JV Co (a new company to be formed) by New Zealand Post Limited and Salmat International Pty Limited, or their subsidiaries, in approximately equal proportions; and the acquisition by JV Co of the assets of the unaddressed mail delivery businesses of Letterbox Channel Limited and Deltarg Distribution Systems Limited.

Dated this 12th day of September 2007

David Caygill
Deputy Chair