



COMMERCE COMMISSION

Decision No. 717

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

SONOCO NEW ZEALAND LIMITED

and

T.T.L PACIFIC LIMITED

The Commission: Mark Berry
Gowan Pickering
Stephen Gale

Summary of Application: The acquisition by Sonoco New Zealand Limited of the business assets of T.T.L Pacific Limited.

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

Date of Determination: 3 February 2011

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THE PROPOSAL

1. A notice under s 66(1) of the Commerce Act 1986 (the Act) was registered on 23 November 2010. The Notice sought clearance by Sonoco New Zealand Limited (Sonoco or the Applicant) seeking clearance to acquire the business assets of T.T.L Pacific Limited (TTL Pacific).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or 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 11 February 2011.
3. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

ANALYTICAL FRAMEWORK

4. 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).
5. 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 scenarios, in terms of:
 - existing competition;
 - potential competition; and
 - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Sonoco New Zealand Limited

6. Sonoco is the New Zealand subsidiary of the Sonoco Products Company which is listed on the New York Stock Exchange. In New Zealand, Sonoco manufactures and supplies cylindrical cardboard cores, tubes and packaging for:
 - cores around which products such as cling film, tapes, carpets, paper and newsprint are wound;
 - labelled cylindrical packaging for consumer products; and

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

- construction formers for the manufacture of concrete pillars or ducts and other cavities in concrete.
7. Sonoco has three manufacturing plants in New Zealand which are located in Auckland, Kawerau and Christchurch. The Kawerau plant exclusively manufactures cylindrical cardboard cores around which the newsprint, packaging paper and hygienic products paper produced in the four pulp and paper mills in the Bay of Plenty region² are wound.

T.T.L Pacific Limited

8. TTL Pacific is a privately owned company whose plant is located in Auckland. In a similar manner to Sonoco, it manufactures and supplies cylindrical cardboard cores and tubes. In contrast to Sonoco, it does not manufacture and supply labelled cylindrical packaging for consumer products.

MARKET DEFINITION

9. The Act defines a market as:³
- 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.
10. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the 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.
11. As stated, Sonoco produces labelled cylindrical packaging for various consumer products⁴. TTL Pacific does not. Therefore, no aggregation of market share in the production of labelled cylindrical packaging would arise from the proposed acquisition and this product is not discussed further in these reasons. Aggregation of market share would occur in the manufacture and supply of cylindrical cardboard cores and tubes and that has been the focus of the Commission's analysis.
12. The Applicant suggested the following:
- for customers in the industrial and construction industries it is appropriate to distinguish between those who acquire their cardboard cores and tubes in a "bidding market" and those who acquire them in a non-bidding market. That is, according to Sonoco, there is a customer dimension to the market;
 - in many instances plastic and steel cores and tubes are substitutable for cardboard cores and tubes and accordingly, it is appropriate to include all three types in the same market;
 - producers of cardboard cores and tubes can switch readily between manufacturing different sizes of cores and tubes and accordingly, it is appropriate to place all sizes within the one market;

² These plants are owned by Norske Skog, SCA Hygiene and Carter Holt Harvey (2 plants). Carter Holt Harvey's plant at Kinleith is regarded as being in this region for the purposes of these reasons.

³ Section 3(1A) of the Act.

⁴ For example, containers for pepper.

- the relevant functional market is the manufacture and wholesale supply; and
 - as paper mill customers have different needs, including just-in-time delivery, there is a separate market for Bay of Plenty (where the paper mills are located). Further, as there is little product transported between islands, it is appropriate to have separate North Island (excluding Bay of Plenty) and South Island markets.
13. The Commission has taken account of the submissions of the Applicant (as summarised above), of TTL Pacific and other manufacturers, and of the principal acquirers of cores and tubes, when analysing the proposed acquisition.

Customer Dimension

14. The Commission does not consider that, in this instance, producers have a different level of market power when supplying customers who call for tenders (that is, operating in what Sonoco has called a “bidding market”) and those that do not (the “non-bidding market”). Producers and customers can readily switch between the two means of transacting. In the Commission’s view there is no basis for differentiation of the market by the means customers use to transact.

Product Market

High specification cores and standard specification cores and tubes

15. The Commission understands that there is an important difference between the requirements of different categories of cardboard core users. In particular, pulp and paper mills, require generally thick cross section cores (9mm to 13mm) manufactured to very fine dimensional tolerances on their internal and external diameters, straightness and lengths. An example of such fine tolerances is plus or minus 0.2mm on a core outside diameter of 100mm.
16. To retain these fine tolerances and ensure dimensional stability after initial manufacture, the moisture content of the paper mill cores must be controlled at specific levels by heat treatment in purpose built ovens. A typical example of control of moisture content is a specified 7% core moisture with zero tolerance permitted on that figure.
17. These cores have been termed high specification cores in these reasons. Both Sonoco and TTL Pacific manufacture high specification cores.
18. On the other hand, other cores and tubes (called standard specification cores and tubes in these reasons) are of a generally thinner cross section (less than 6 to 7 mm) and may be manufactured to coarser dimensional tolerances and with moisture contents at ambient levels. Products such as carpet and textiles wound on and off such cores at low speeds do not require the same degree of fine dimensioning that high specification cores require and dimensional stability between manufacture and use is not so important, alleviating the need for heat treatment of these standard cores and tubes.⁵
19. The Commission is satisfied that high specification cores have distinctive properties which mean that they are not substitutable for standard cores on either the supply side or the demand side. However, the various types and sizes of standard cardboard cores and tubes appear to be readily substitutable for each other on the supply side.

⁵ The high specification market includes only cores. The standard specification market includes both cores and tubes. Examples of the uses of cardboard tubes are as postal containers, for concrete forming and for sheaths protecting rolls of textile during their transport.

20. In this respect the Commission notes the decision of the Commission of European Communities on the Sonoco/Ahlstrom matter:⁶

While there were indications that supply-side substitutability exists to a sufficient degree at least between other PMC (paper mill cores), other textile cores, uncoated film cores and other cores (altogether “low-value cores”), the market investigation confirmed that especially for the production of high-value products, such as high-end PMC and yarn carriers, specific know-how and machinery are needed. As a result, three different product markets can be distinguished: one for high-end PMC, one for yarn carriers, and one for low-value cores.⁷

Plastic cores

21. During the Commission’s investigation, the paper mills advised the Commission that plastic cores are not acceptable to their customers. They advised that plastic cores are too heavy for customers to easily manhandle when unwound, their extra weight adds to export freight costs, and recycling from their mainly export customers is impractical.⁸ The paper manufacturers in New Zealand, the predominant users of high specification cores, do not use plastic cores⁹ nor do they know of situations, where overseas producers use anything other than cardboard cores. It appears to the Commission that cardboard is the industry standard material used for high specification cores for pulp and paper mills. In this instance, the Commission does not consider that plastic is a substitute for cardboard in the manufacture and supply of high specification cores.
22. The evidence is less conclusive in respect of standard cores. A major user, [], stated that imported plastic cores are a practical and economic substitute (at least when the exchange rate is satisfactory) and in the past it has substituted imported plastic cores for locally-produced cores for as much as 85% of its output. Other users of standard cores who were interviewed, were less convinced about the degree of substitutability, although for many, some substitution is possible in certain circumstances.
23. In this instance the Commission has adopted a conservative approach and has considered competition in the market for standard cores made of cardboard. The degree of competitive constraint provided by cores made from plastic and other material is taken into account in the competition analysis below.

Functional Market

24. The Applicant’s submission that the relevant functional market is that for the manufacture and wholesale supply is accepted by the Commission.

Geographic Markets

Standard Specification Cores and Tubes

25. The North Island producers of standard specification cores are all based in the Auckland region. While the majority of their significant customers are in the Auckland region, the producers compete for customers throughout the North Island.

⁶ The Commission of the European Communities, *Case no. COMP/M3431 – Sonoco/Ahlstrom*.

⁷ *Ibid* para 42. The Commission notes that yarn cores are not a large part of New Zealand markets.

⁸ The Commission was informed that plastic cores would only be economic in a situation where a paper mill’s customer was located very close to the paper mill which would allow plastic cores to be easily recyclable from customer to paper mill.

⁹ [

26. The producers of cores in the South Island are Sonoco and South Core Limited, both at Christchurch sites. South Core Limited sends [] cores to the lower half of the North Island []. The Commission understands that Sonoco supplies its customers in the lower half of the North Island from its Auckland factory rather than its Christchurch factory.
27. There is a clear transport cost advantage if the user is close to the producer. However, as all North Island producers of standard cores are situated in Auckland, each would face similar freight costs irrespective of where in the North Island the customer is located. The Commission considers that in these circumstances it is appropriate to assess the competitive impact on standard cores within a North Island-wide geographic market.

High Specification Cores

28. The situation in respect of high specification cores is different. Sonoco submitted that this type of core is never transported for significant distances because:
- of the high relative cost of freighting a bulky, low value product;
 - cores become spoiled due to adverse weather and humidity conditions, and physical damage;
 - the exigencies of paper mill production require flexibility in the manufacture and supply of cores whose required dimensions may be altered by the paper mill at short term notice. In some cases cores which are not used by the paper mill on the day of delivery must be returned to the core manufacturer for re-processing. Such flexibility would not be possible if core production was located at long distances from the paper mills concerned; and
 - given that the cores are a vital component for paper mill operation, mill operators insist on the core manufacturer being located close to their mills. That situation exists in both New Zealand and Australia.
29. Therefore, Sonoco's position is that the high specification core market is a local market. Sonoco's output is restricted to the Bay of Plenty region.
30. At present, there is one factory capable of producing high specification cores in Auckland (TTL at Henderson) and one factory capable of producing high specification cores in the Bay of Plenty (Sonoco at Kawerau). Each appears to be the single supplier in their respective regions. This would suggest regional markets.
31. Sonoco advised that it has not attempted to supply Carter Holt Harvey's Penrose paper mill from Kawerau because [

].¹⁰

32. Similarly, the Bay of Plenty paper mills at Whakatane, Kawerau and Kinleith source solely from Sonoco's Kawerau factory. In response to an invitation to tender from Carter Holt Harvey, TTL Pacific recently tendered to supply Carter Holt Harvey's plants in the Bay of Plenty. [

¹⁰ [

].¹¹

33. These facts imply that to be an effective competitor in the high specification core market, it is necessary for the supplier's plant to be situated in the locality of its high specification core customers.
34. Accordingly, the Commission has concluded that the existing manufacturers of high specification cores based in Auckland and in Kawerau do not currently compete with one another as they supply separate geographic markets.

Conclusion on Market Definition

35. The Commission has concluded that for the purpose of assessing the competitive impact of the acquisition the relevant markets are:
- the North Island market for the manufacturing and wholesale supply of standard cardboard cores and tubes (the Standard Specification Core Market); and
 - separate Bay of Plenty and Auckland markets for the manufacturing and wholesale supply of high specification cardboard cores (the High Specification Core Markets).

COUNTERFACTUAL AND FACTUAL

Factual

36. In the factual scenario, Sonoco would acquire TTL Pacific and its operations at Auckland. Sonoco advised that its rationale for the proposed acquisition is to create efficiencies of scale. Sonoco advised that, in its view, [

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37. [

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Counterfactual

38. Sonoco advised that demand for its products in New Zealand (other than high specification cores) has been decreasing for some time. This is particularly the case in respect of the standard cores manufactured at Sonoco's Auckland and Christchurch plants. According to Sonoco, [

]

39. [

], the Commission considers that the appropriate counterfactual is TTL Pacific and Sonoco continuing their current businesses from their existing locations, that is, the status quo.

¹¹ [

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COMPETITION ANALYSIS – THE STANDARD SPECIFICATION CORE MARKET

Existing Competition

40. Table 1 shows the estimated market share for the standard specification core market.

Table 1: Market Shares for the Standard Specification Core Market

Party	Turnover (\$m)	Market Shares (%)
Sonoco (Henderson)	[]	[]
TTL Pacific	[]	[]
<i>Combined Entity</i>	<i>[]</i>	<i>[]</i>
Raven Rolls Limited	[]	[]
Total	[]	100

Source: Industry participants' sales during 2010.

41. The Applicant submitted that there are a number of parties that compete with Sonoco and TTL Pacific. However, as the table indicates Sonoco and TTL Pacific are the predominant suppliers in the North Island and have been for some time. Raven Rolls Limited (Raven Rolls) only entered the market recently which explains its small market presence.

Constraint from other competitors

42. Raven Rolls was established in Auckland in 2009. It has one machine, similar to those utilised by TTL Pacific and Sonoco and there is no significant difference between the standard specification cores and tubes it produces and those of the Applicant or TTL Pacific. However, Raven Rolls' facility is significantly smaller than those of TTL Pacific and Sonoco. []].

43. The degree of competitive constraint imposed on the merged entity, particularly if the remaining competitors in the market are small, would depend on their ability to expand if incentivised by the actions of the combined entity.

44. The Applicant and TTL Pacific advised that there are minimal barriers to expanding the existing production of standard cores. Essentially, all that is required is to run the existing machinery for longer periods, as the two main raw materials required in the production process (paperboard and industrial glue) are readily available. In this respect, Raven Rolls advised that it is not capacity constrained. []].

45. In addition, Auckland Paper Tubes Limited is at an advanced stage of establishing a cardboard core manufacturing plant in Auckland. It recently purchased a new machine from Taiwan which has been commissioned by the supplier.

46. Auckland Paper Tubes Limited is partially owned by Gary Davidson of Davidson Plastics Limited, a manufacturer of plastic film and plastic bags which itself requires numerous cardboard cores around which those products are wound. Auckland Paper Tubes Limited advised that initially it intends to manufacture cardboard cores for its parent company but will gradually expand its operations to supply other customers []. [] it will have significant spare capacity to supply other customers in the near future.
47. The Commission considers it likely that both Raven Rolls and Auckland Paper Tubes Limited would provide a degree of competitive constraint, post-acquisition in the standard specification core market.

Constraints from outside the market

48. The Applicant submitted that many customers have the ability to switch from cardboard cores to plastic cores. The Commission understands that plastic may be economic, particularly for low value small diameter cores such as cellotape rolls or till-receipt rolls. In these situations, the end customer is often ambivalent as to whether the product has a plastic or a cardboard core. For example, [] estimated that perhaps as much as 85% of the till-receipt rolls and label rolls it produces could have either a plastic or cardboard core.
49. Nevertheless, most existing customers were adamant that cardboard cores have distinct advantages over other cores made from alternative materials and that they would not switch to plastic cores unless they were faced with a substantial price increase.
50. [] advised that the cardboard tubes and cores it purchases are the cheapest and most cost-effective product for its requirements. Some time ago it switched to a particular type of plastic core which, at the time, was comparable in price to cardboard. However, that has changed and the current price makes plastic cores significantly more expensive than those supplied by its existing cardboard core supplier, [].
51. It appears to the Commission, and industry parties have confirmed, that plastic cores of any size would only be economic in a situation where the supplier of a product wound around a plastic core is located very close to the main consumer of that product. That would then allow easy recycling of cores back to the supplier for re-use.
52. In the Commission's view while in certain circumstances plastic cores could offer an alternative and would provide a degree of competitive constraint, this constraint does not apply to a large proportion of existing customers who would continue to have a strong preference for standard specification cardboard cores.

Conclusion on the Standard Specification Core Market

53. Sonoco and TTL Pacific are the two largest suppliers of cores in the North Island. Until recently, they were the only two suppliers in the market. There are two other parties who have recently entered, or are in the process of entering, the market. They have done so with a relatively low level of investment and industry expertise.
54. Further, it appears that the barriers to expansion in the manufacture and supply of standard specification cores and tubes are relatively low. All existing competitors advised that they had significant spare capacity and could easily expand their production, particularly if incentivised by the actions of the combined entity. The products are relatively homogenous and there is evidence of significant customer switching between suppliers. In addition, some customers would have the ability to switch to an alternative material such as plastic.

55. Accordingly, the Commission considers that the proposed acquisition is unlikely to result in a substantial lessening of competition in the standard specification core market.

COMPETITION ANALYSIS – HIGH SPECIFICATION CORE MARKETS

56. In New Zealand, there are two existing manufacturers of high specification cores and a limited number of customers, almost exclusively the paper mills located in Auckland and the Bay of Plenty region. As discussed above, the Commission considers that there are separate geographic markets in Auckland and the Bay of Plenty for the manufacture and supply of high specification cores. In this respect there will be no aggregation of market share in the high specification core markets.
57. Rather, the only change in competition in the high specification markets post-acquisition would be the loss of TTL Pacific and Sonoco as potential respective entrants into the Bay of Plenty and Auckland regional markets. Given the common view expressed by disparate parties in their submissions to the Commission as to the impracticality of long distance supply of high specification cores to plants such as the Bay of Plenty paper mills, it appears that it would only be feasible for such entry to be achieved by the construction of a new plant relatively close to the high specification core customers.
58. The Commission does not consider that the [] high specification core purchases of Carter Holt Harvey Penrose¹² would be likely to justify the investment that would be required by a new entrant (Sonoco or a de novo entrant) in order to supply Penrose. Accordingly, the Commission does not consider there is a loss of competition in the Auckland market.
59. TTL Pacific submitted that its existing position in respect of supply to the Bay of Plenty is no different to that of a green field entrant. It would need to make the same financial commitments as anyone else and that it has no advantage through its position as an existing supplier in Auckland.
60. Sonoco advised that there are a number of parties in Australia which have recently established core manufacturing plants near to pulp and paper mills, and who could do the same in New Zealand if sufficiently incentivised.
61. The Commission also notes that it might be possible to enter the market, without replicating the existing scale of Sonoco's Kawerau plant. For example, Tubepak Pty Limited (Tubepak), the Brisbane-based core manufacturer advised that it had recently built a new plant to enter the Queensland high specification core market and relatively quickly gained a contract to supply [] the core requirements of Visy's new Brisbane paper mill []. Tubepak is the company owned by a former Sonoco executive who [] saw an opportunity to compete with Sonoco in the Brisbane region¹³.
62. Sonoco argues, and Tubepak agreed, that it would thus be feasible for such an entrant to set up in the Bay of Plenty if it had a contract to supply one of the three paper mill companies operating there. Tubepak confirmed Sonoco's submission that the conditions of entry into this market are not onerous and that machinery is relatively inexpensive.

¹² []

¹³ []

63. Tubepak also noted Sonoco's submission that South East Asian core manufacturers had some time ago visited paper mills in Australia to discuss their entry into core manufacturing markets, although nothing has come of the suggestion.
64. In the Commission's view, the acquisition would result in the loss of one potential entrant into the Bay of Plenty high specification core market. However, the example of Tubepak's easy entry into Brisbane markets demonstrates that entry is not difficult.

Conclusion on the High Specification Core Markets

65. The Commission considers that:
- there would be no aggregation of market share as a result of the acquisition nor loss of existing competition because TTL Pacific and Sonoco currently supply different geographic markets; and
 - while TTL Pacific would be removed as a potential entrant into the high specification core market in the Bay of Plenty, the Commission considers that, nevertheless, entry is likely should the combined entity exercise market power.
66. Accordingly, the Commission considers that the proposed acquisition is unlikely to substantially lessen competition in the high specification core markets.

OVERALL CONCLUSION

67. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in:
- the North Island market for the manufacturing and wholesale supply of standard cardboard cores and tubes (the Standard Specification Core Market); and
 - separate Bay of Plenty and Auckland markets for the manufacturing and wholesale supply of high specification cardboard cores (the High Specification Core Markets).
68. In respect to the Standard Specification Core Market, while Sonoco and TTL Pacific have been the two largest suppliers of cores in the North Island, there are two other parties who have recently entered, or are in the process of entering, the market. Further, it appears that the barriers to expansion are relatively low. All existing competitors advised that they had significant spare capacity and could easily expand their production, particularly if incentivised by the actions of the combined entity and some customers would have the ability to switch to an alternative material such as plastic.
69. In respect to the High Specification Core Markets, there would be no aggregation of market share as a result of the acquisition because TTL Pacific and Sonoco currently supply different geographic markets. TTL Pacific would be removed as a potential entrant into the high specification core market in the Bay of Plenty although the Commission considers that entry is likely should the combined entity exercise market power.
70. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any market.

DETERMINATION ON NOTICE OF CLEARANCE

71. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Sonoco New Zealand Limited to acquire the business assets of T.T.L Pacific Limited.

Dated this 3rd day of February 2011

Dr Mark Berry
Chair